



Abt Associates Inc.

# **Support for the provision and institutionalization of business finance services in Kosovo**

## **Report to USAID/Kosovo**

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## Glossary

BPK.....	Banking and Payments Commission of Kosovo
CFA.....	Central Fiscal Authority
COP.....	Chief of Party
CORDAID .....	Catholic Organization for Relief and Development Aid
COTR.....	Contracting Officer's Technical Representative
CTO .....	Cognizant Technical Officer
DTI.....	Department of Trade and Industry
EAR.....	European Agency for Reconstruction
EU.....	European Union
FRY.....	Federal Republic of Yugoslavia
GDP.....	Gross Domestic Product
GTZ.....	Gesellschaft für Technische Zusammenarbeit
ICMC .....	International Catholic Migration Committee
ICU.....	Interim Credit Unit
IFDC.....	International Fertilizer Development Center
KEP.....	Kosovo Enterprise Board
KPA.....	Kosovo Privatization Agency
MCI .....	Mercy Corps International
MEB.....	Micro Enterprise Bank
MFI.....	Microfinance institution
NGO.....	Non-government organization
PVO.....	Private voluntary organization (= NGO)
SME.....	Small and medium-sized enterprises
SRSG .....	Special Representative of the Secretary General
TAC .....	Technical Advisory Commission (to UNMIK)
TU .....	Technical Unit
UNMIK .....	United Nations Interim Administration Mission in Kosovo)
USDA .....	US Department of Agriculture

# Introduction

This report is the product of a three-week assignment for a team of experts in development finance, microfinance, banking and business development, fielded by the Abt Associates SEGIR Financial Services Consortium, in support of USAID/Kosovo's program development efforts in the provision and institutionalization of business finance services in Kosovo. The team was working closely with USAID staff from the Mission and Washington and provided inputs into the design of a major planned initiative in support of economic recovery and growth in the province.

Annex A presents the terms of reference for the assignment. The RFP called for "work activities geared towards development of a practical business financing strategy and facility, and corollary business advisory support strategy, which will effectively contribute to meeting immediate business finance and non-financial support needs in Kosovo; while contributing simultaneously to institutional development of ... Kosovo's financial system." For a number of reasons, the assignment needed to be completed in a very tight time frame, although USAID granted additional time for compiling and editing this final summary.

The work focused on issues of programmatic interest, specifically the (unmet) needs for business finance and non-financial support services and relevant demand characteristics, the principal options for USAID interventions to meet these needs, and the parameters and features of the most suitable programmatic response. The team's reports and notes on these issues form the core of this report. To place the diagnostics and proposed interventions in a reasonable context, the report uses information from other sources, including the RFP, to complement the field work and recommendations of the team.

The report therefore begins with a brief overview of the current situation, focusing in particular on the emerging legal and regulatory framework. It then presents an analysis of needs and demand characteristics for finance and non-financial business support services. The concluding section outlines options for USAID intervention, and provides specific recommendations.

## The setting

### Background

The Serb invasion and ethnic cleansing of the province of Kosovo, which led to the NATO intervention in March-June 1999, devastated what was already the poorest province in the Federal Republic of Yugoslavia (FRY), with widespread unemployment and crippling debt. The conflict exacted a heavy human toll and laid waste to the Kosovo economy. It drove almost half of the population of Kosovo from their homes, and left almost half of the housing stock in ruins. It destroyed much of the province's infrastructure, and put much of its productive capacity out of commission.

Repairing the damage and rebuilding the economy will be a protracted and difficult process. But with international assistance and under the oversight of the UN administration (United Nations Interim Administration Mission in Kosovo — UNMIK), Kosovo is beginning

to recover. There has been significant progress in the reconstruction of the province's infrastructure and housing. Moreover, a sound macroeconomic policy framework is beginning to emerge, and steps have been taken to establish the legal and regulatory environment necessary for the functioning of a market economy.

At this point, the most urgent need is to build on these accomplishments and rekindle business activity to create real jobs, absorb unemployment, and raise incomes. As discussed in greater detail below, several initiatives are under way to support efforts to get businesses going again, through both credit programs and business support services. So far, however, the credit programs have concentrated on the low end of the market, mostly concerned with short-term lending to microenterprises and small businesses, with total disbursements to date of less than \$3 million. Similarly, technical assistance to businesses provided by NGOs has favored the micro and small enterprise end of the spectrum, although the largest businesses, the "crown jewels" like the Trepca mines, are also beneficiaries of technical advice and support. The greatest need for both finance and development services is therefore in the upper range of the small enterprise sector and for medium-sized businesses.

## **The legal and regulatory framework**

### ***An evolving structure***

Kosovo's legal and regulatory framework is evolving. It is a mix of the "old law," the constitution and laws of the Yugoslav Federation (FRY) and the Republic of Serbia, and of the "new," the regulations and rules being promulgated by UNMIK. With the 1989 revocation of its autonomy, Kosovo became an integral part of the Republic of Serbia. It was therefore in principle subject to Serbian law and to the April 27, 1992, new constitution of the FRY, the supreme law of the FRY constituents, the Republics of Serbia and Montenegro. UNMIK is proceeding on the basis that the relevant legal framework is the body of law in force prior to the revocation of Kosovo's autonomous status. Others have argued that the 1992 constitution of the FRY and Serbian law do in fact apply, as they evolved over the ten years preceding UN Resolution 1244 of 1999. That interpretation would mean that the basic framework today incorporates the acts, decrees and amendment, at both the federal and republic levels, promulgated between 1989 and 1999. These changes were largely inimical to the development of a market economy. They tend to be restrictive and would be especially troublesome to the legitimacy of any reform to the tax system and the privatization of "socially owned" assets and enterprises.

UN Resolution 1244 of 1999 places Kosovo under the authority of the Secretary General of the United Nations, giving it a substantial degree of autonomy. The province is governed by the Special Representative of the Secretary General (SRSG) in charge of UNMIK. UNMIK Regulation 1999/1 vests all legislative and executive powers in the SRSG. The Federal Republic of Yugoslavia (FRY) has consented to UNMIK's mandate and Kosovo's autonomy that it entails. UNMIK Regulation 1999/24 establishes the following order of precedence among these elements:

- (1) Regulations and rules issued by UNMIK and its instrumentalities.
- (2) The laws of the FRY in force on March 23, 1989, prior to the revocation of Kosovo's status as an autonomous province.

- (3) On any matter of law that is not covered by the above, the relevant law in force in Kosovo after March 23, 1989, may be applied, insofar as it is not discriminatory and complies with the eight international conventions on human rights.

Since it is in effect in control of the province with the consent of the FRY, UNMIK's position prevails. UNMIK Regulation 1999/24 therefore defines the effective legal framework for Kosovo.

Overall, therefore, the legal framework is currently in a state of transition as legal experts are drafting rules and regulation for UNMIK. The development and promulgation of these regulations into a coherent structure represents a major challenge, given remaining uncertainties and a lack of clarity. These problems are magnified by the disruptions and displacements in the wake of the conflict. One of the issues facing the drafters for UNMIK regulations governing economic activity is the degree to which the provisions or rulings under these regulations will be binding on any successor to UNMIK in the government of Kosovo. It appears that this issue is not handled in a consistent manner in the drafts of some key regulations, which of course is not conducive to a creating a more secure investment environment.

UNMIK Regulation 1999/1 also puts the SRSG in charge of the administration of the judiciary. The Yugoslav court system consists of Federal Courts for appeals and Republic Courts. The Republic of Serbia Court System consists of municipal, district and a supreme court. Municipal courts have original jurisdiction over commercial and general jurisdiction cases; district courts also have original jurisdiction and appeals from the municipal level; the supreme court only handles appeals arriving from the district level. Conflicts between federal and republic laws were to be resolved by the Federal and Constitutional Courts of the FRY. UNMIK's Technical Advisory Commission (TAC) has recommended to the SRSG that the Kosovo judiciary system should be upgraded to handle commercial cases, maintain company, real estate and mortgage registers, and develop a complementary system of mediation and arbitration to settle disputes.

### ***Business organization, investment and trade***

The *FRY Enterprise Law* governing juridical persons is somewhat bureaucratic, but does not otherwise obstruct the registration or establishment of enterprises. UNMIK is in the process of developing a new *Regulation on Business Organization*. In its present form the draft regulation is clear, fair and comprehensive. It is intended exclusively for enterprises that engage in business for profit.<sup>1</sup> Those enterprises may be: Personal Business Enterprises (sole proprietorships) and General Partnerships as non-juridical persons; Limited Partnerships and Corporations, which in turn are subdivided into Open or Closed Joint Stock Companies.

The draft contains rules for allocation of liabilities for each type, public registration,<sup>2</sup> mandatory records, governance, liquidation procedures and priorities, rights of shareholders

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<sup>1</sup> Banking Regulation 21 defines legal persons as joint stock companies with limited liability, and sole proprietorships and partnerships with unlimited personal liability. Banking Rule XIV defines foundations, associations, NGOs and MFIs.

<sup>2</sup> UNMIK is currently conducting a drive to register enterprises as well as individuals. Enterprises are being registered by the municipalities or municipal courts and individuals by OSCE, an UNMIK agency. Finca Kosovo, a



including preemptive rights, public offerings, duties and responsibilities of directors and officers, conflicts of interest, minimum capital<sup>3</sup> (DM 10,000 for closed and DM 50,000 for closed joint stock companies), dividends, external audit and financial reporting requirements and adoption of IAS.

The FRY *ownership, concessions, contract and expropriation laws* actually provide a reasonably supportive framework for the development of a market economy. However, they are not always clear, and this lack of clarity has been exacerbated by the conflict. UNMIK's draft *Regulation on Ownership of Non-Residential Assets*<sup>4</sup> seeks to establish a coherent framework for resolving questions of ownership. The draft proposes the creation of an Ownership Adjudication Commission (OAC) to ascertain the ownership of all movable and immovable, tangible and non-tangible nonresidential assets, with exclusive jurisdiction and finality of decision without further appeal. UNMIK is also reportedly working on a draft *Regulation on Contracts*.

UNMIK's draft *Regulation on Pledge Transactions* covers movable property and contains clear definitions and equitable rules on pledges, attachments, liens, notifications, and filing and perfection of security interests. It covers conditional sales with retention of title, leases, order of preference or priority of claims and transferability. However, on the matter of fixtures this regulation has to depend on related laws or regulations on real estate property, on contracts and on business enterprises, which have yet to be promulgated.

The FRY *Foreign Investment Law*, including its restrictions on foreign control of media and telecommunications, is comparable to the corresponding legislation in other market economies. Foreign investors in financial institutions are reasonably required to comply with all the related rules and regulations. UNMIK is reported to be developing a *Foreign Investments Regulation*; it has already covered the area with respect to banks and other financial institutions through Regulation 21 and its ancillary rules.

The FRY laws on *foreign loans and foreign exchange* were originally rather restrictive. Amendments (June 29, 1999) made them even more onerous. These laws stand in stark contrast to the freedom of exchange, remittances and capital flows currently permitted by UNMIK.

The FRY *internal trade and foreign trade laws* are symptomatic of a restrictive economic environment and are not conducive to freedom of trade. The Foreign Trade Law was designed, at least on paper, to be more favorable to foreigners than to nationals. The 1999 amendments added restrictions and further confused the application of these laws. UNMIK apparently is not planning to regulate trade, except through future environmental and consumer protection regulations.

Yugoslav *tax laws* apply at the federal, republic and local government levels. The FRY assesses national taxes on sales, profits, income, real estate and property. Serbia imposes very high

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Prizren MFI, requires loan applicants to register their enterprises with UNMIK, while MEB, the new bank, does not.

<sup>3</sup> The draft acknowledges that although banks must be organized as joint stock companies, they are subject to different minimum capital requirements, which are established by the banking rules and regulations currently in force.

<sup>4</sup> For residential properties the proposed vehicles would be the Housing and Property Claims Commission and the Housing and Property Directory.

excise, sales and service taxes. Local governments are allowed considerable latitude in assessing taxes on just about anything. Although the Yugoslav tax system is reasonable and comparable with those of other nations in the region, the high level of Serbian taxes and the unpredictable taxation policies of local governments could counter the beneficial effects of other programs designed to promote privately owned enterprises.

UNMIK has organized the Central Fiscal Authority (CFA) to assess and collect taxes. To date, UNMIK is only collecting customs duties. There is no indication whether other fiscal measures are planned. Until UNMIK establishes a new and comprehensive tax code, there will be uncertainty about the possible applicability of the old tax laws.

## ***Financial sector***

While the financial system is in its infancy, it is growing in an environment protected by a strong currency and sound banking regulations and supervision, making it easier to establish new domestic or to attract foreign financial institutions. The FRY ***banking laws*** (the National Bank of Yugoslavia Law, the Banking and Financial Institutions Law, and the Law on the Liquidation of Banks) cover the central bank, monetary authority, banking regulation and supervision, banks, post office savings companies, credit unions, savings and loan cooperatives and other financial institutions. UNMIK has filled the bank regulatory vacuum in Kosovo with sound and comprehensive rules and regulations.

UNMIK Regulation 21, ***On Bank Licensing, Supervision and Regulation***, with its 53 Sections and 14 supporting Rules, provides a hospitable environment for responsible potential domestic and foreign bankers and lenders.

UNMIK Regulation 20 created the ***Banking and Payments Commission of Kosovo*** (BPK)<sup>5</sup> which has already permitted one full service bank to open, has granted 6 preliminary approvals for new banks, and has registered at least 5 or 6 microfinance institutions, including the World Bank's Interim Credit Unit (ICU), which is designed to lend to SMEs directly and indirectly, through Kosovo's emerging banking system.

The BPK's rule XIV covers the registration, licensing and supervision (if applicable) of microfinance institutions (MFIs). The rule is comprehensive and well defined. It also reasonably establishes different requirements for deposit taking and non-depository MFIs. There are already five MFIs lending to micro, small and medium enterprises in Kosovo.

To our knowledge, no legal or statutory restrictions on ***interest rates*** exist or are planned.

The FRY ***Privatization Law*** embodies general principles intended to guide the republics in drawing up their privatization statutes. The Serbian ***Ownership Transformation Law*** of

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<sup>5</sup> UNMIK Regulation 20 makes the BPK an autonomous agency with a capital of DM 5 million and gives it the right to administer the property of the National Bank of Kosovo and the Public Payments System. It is also charged with owning and operating the payment and settlement system, making it the official clearing house; to act as fiscal agent for the Central Fiscal Authority (CFA), to hold the foreign currency of banks, the CFA and official institutions; to supply currency to the system and act as depository and safekeeping agent; to license and supervise banks and foreign exchange dealers. In short UNMIK has made the BPK the equivalent of Kosovo's Central Bank and Banking Superintendent. It is also allowed, for a maximum period of two years, to accept demand deposits from the general public and to provide payments and collection services. If during the two-year period the BPK determines that the private banking system is equipped to provide such services, it will cease providing them.

1997 is considered cumbersome and deeply flawed by a requirement for management consent to privatize any “socially owned” enterprise.

While the issues related to UNMIK’s rights to transfer property ownership are being settled, UNMIK has placed the development of a draft *Privatization Regulation* on hold. The issues arise from the fact that UNMIK’s Regulations have not made it clear that its authority encompasses “social property.”<sup>6</sup> The key questions that will have to be satisfactorily resolved are: whether UNMIK has the right to sell such properties; how to determine ownership rights and competing claims fairly; and if the legitimacy for such sales may be derived from the 1997 Serbian Ownership Transformation Act, since that Act was adopted after 1989. In the meantime, UNMIK is proceeding with the implementation of intermediate arrangements that do not require the transfer of ownership, such as management contracts or leases.

The list of candidates for privatization comprises some 160 enterprises, including 30 large entities. The process envisioned will involve taking control of an enterprise, incorporating it, then privatizing it through competitive bidding open to local and foreign investors, and finally paying compensation to all eligible claimants. UNMIK’s current strategy envisions the creation of the Kosovo Privatization Agency (KPA) under the Department of Trade and Industry (DTI),<sup>7</sup> tasked with executing policies established by the Kosovo Enterprise Board (KEB).

## Conclusions

The existing legal and regulatory framework for the financial sector and its evolution under UNMIK provide a sound base for the establishment and development of financial institutions. In contrast, the absence of contemporaneous regulations in vital areas (business organization or company law; property ownership, titling and registration; mortgages, pledges and liens on property, including the ability to publicly register a security interest; and contracts and bankruptcy) will make it difficult to attract foreign investment. Even the means to function under the old (pre 1989) laws are unavailable because most public registries and cadasters were destroyed or stolen and the court system is barely operational.<sup>8</sup> But even if all of the above problems were to be instantly resolved, the majority of businesspeople in Kosovo lack the business experience and knowledge to make good use of those potential advantages.

These weaknesses in the business environment of course affect the ability of existing and new financial institutions to meet the needs of the enterprise sector as long as they are relying on traditional banking policies and procedures. However, even in the absence of a complete legal infrastructure, there are proven and effective methods to lend to the micro and SME sectors in a relatively safe manner, based on character, reputation, years of experience in business, cash flow, solidarity guarantees and escalating loan sizes, techniques which are the essence of microfinance.

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<sup>6</sup> UNMIK Reg. 21, section 6, gives UNMIK the right to administer any property in Kosovo titled under the FRY or Serbia or any of their organs, but it does not address social property.

<sup>7</sup> The DTI is not expected to provide any financial assistance for the privatization process or to the business sector. It will have no budget for that type of assistance. However, it will be expected to promote economic growth, employment, and consumer protection, and to perform an anti-trust function.

<sup>8</sup> The few functioning courts and judges in Kosovo have to give priority to criminal matters.

# Needs and demand

## The enterprise sector

Since 1989, when Kosovo's autonomy was revoked, ethnic Albanians in Kosovo had been excluded systematically from the formal business sector. They operated in an informal sector, which allowed them to survive, but deprived them of access to organized institutions. The recent conflict severely damaged all sectors of the economy. As businesses attempt to return to normal they face a lack of institutions, legal framework and financial organizations to support their growth. The local banking sector is virtually non-existent, and most businesses lack the skills necessary to prepare formal credit requests even if those institutions existed. Because a survivalist mentality prevailed for the last decade, there is scant knowledge of business planning or financial controls, and the approach to marketing is generally superficial and localized.

As would be expected under such conditions, there is an extreme shortage of business people with knowledge of and experience in running businesses in the more complex, highly competitive, and market-driven international arena. There also exists knowledge gaps in specific skill areas such as accounting, which will become significant once Kosovo adopts international accounting standards for taxation purposes. In short, the Kosovo private sector faces three major challenges:

- (1) gaining access to and competing effectively in more broadly defined markets;
- (2) creating and working through institutions that will facilitate their entry into those markets; and
- (3) developing the business skills, production processes, human capital, and cost structures necessary to thrive in international markets.

Information about the size and characteristics of the enterprise sector is scarce. What exists tends to be unreliable, since most of the businesses existed in the underground economy before the 1999 conflict, and suffered severe dislocations during the conflict. A recent (March 2000) sector assessment sponsored by the World Bank provides some useful information.<sup>9</sup> In addition to some 156 large<sup>10</sup> enterprises that are publicly owned (with 58 of them operating), the enterprise sector comprises perhaps 18-20,000 privately-owned micro and SMEs, of which perhaps half are operating (about 5,000 firms have registered at UNMIK<sup>11</sup>). About half of active enterprises fall into the microenterprise category. Overall, the best guess puts the number of SME firms operating in Kosovo at about 5,000. With private sector contribution to GDP estimated at 47 percent, and GDP estimated at \$1.5 billion, private sector firms generate around \$700 million of value added. If SMEs account for 75 percent of this private sector contribution, the average value added per firm in the SME sector would be roughly \$100,000.

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<sup>9</sup> The summary of the enterprise sector data here relies heavily on the relevant passage in a USAID document.

<sup>10</sup> The World Bank assessment used the following definitions: micro (1-5 employees), small (6-20), medium (21-250), and large (over 250).

<sup>11</sup> Around 17,000 enterprises were registered in 1998 of which 55 percent were operating in a continuous manner.

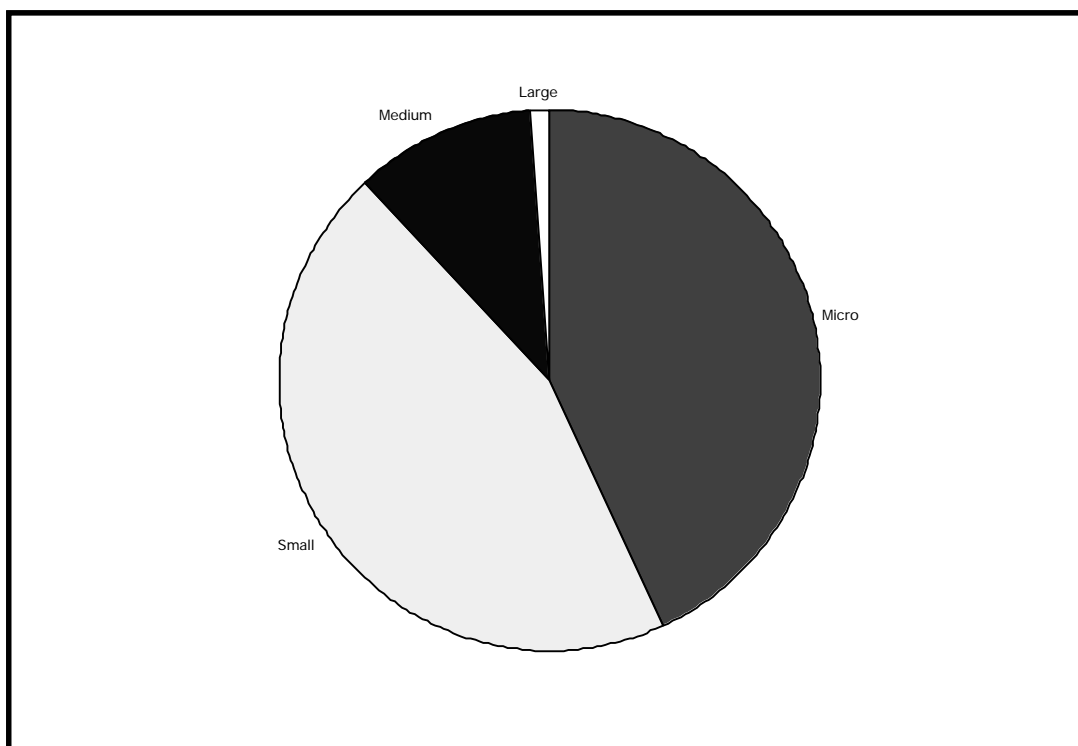
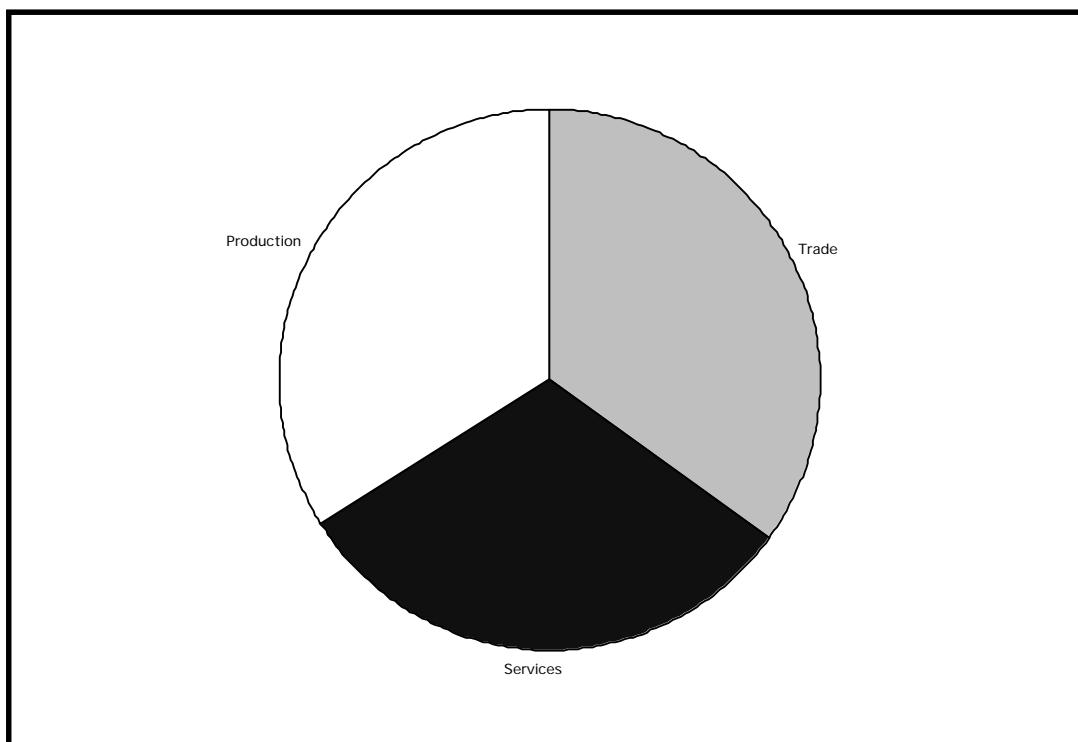
**Exhibit 1: Estimated composition of enterprise sector by size****Exhibit 2: Enterprises by sector**

Exhibit 1 shows the estimated size distribution of the Kosovo enterprise sector, and Exhibit 2 illustrates its sectoral composition.<sup>12</sup>

Other findings of the enterprise sector assessment illustrate the lack of financial services. The vast majority of business transactions relies on trade or cash barter. Only 22 percent of the enterprises had bank accounts (all abroad), only 3 percent had outstanding loan balances, and 3 percent had a bank overdraft.

To complement available data, the team carried out its own small informal survey in the center of Pristina of 16 enterprises. One out of the 16 had registered (as compared to accepted assumptions of 50 percent registration).

Most business owners in Kosovo are men. Only two of the 16 enterprises had female owners. The World Bank-sponsored assessment had similar results, showing that only 2.7 percent of the surveyed enterprises were owned by women. That survey also found that 67 percent of the enterprises had a single owner.

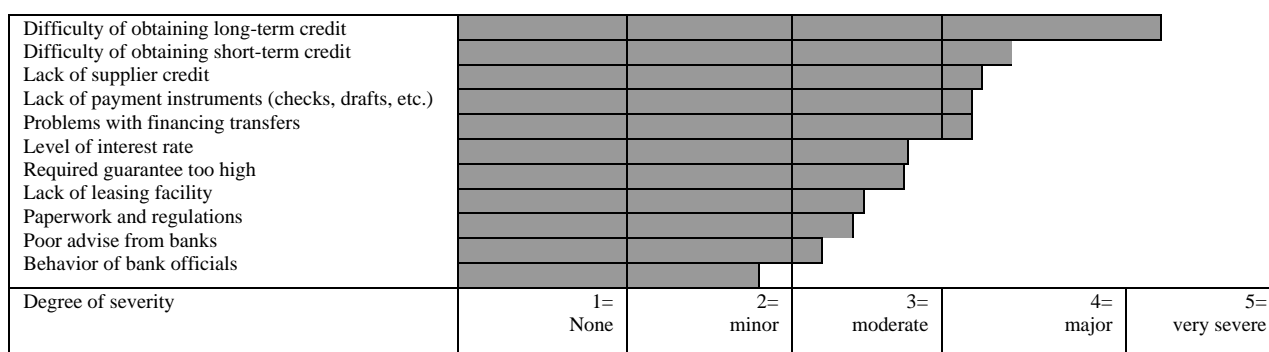
In general, enterprises lack marketable collateral. Most equipment and machinery was destroyed during the conflict along with most public registries and cadasters. The businesses rarely keep financial statements and never audited ones. Most also lack a credit history with formal lenders as in the past bank loans were limited to state-owned enterprises. All these factors compounded by the lack of legal framework make the chances for accessing credit from formal financial sources very limited.

## Access to finance and loan demand

### *Finance as a constraint*

The World Bank survey showed that of the 16 constraints to operating and expanding enterprises identified, by far the most significant (84 percent of responding enterprises) was the lack of financial resources and investment. Respondents cited “difficulty in obtaining long-term credit” (noted as very severe) as the most serious finance constraint; it was followed by “difficulty in obtaining short-term credit” (noted as major). Exhibit 3 illustrates the relative importance of various constraints.

**Exhibit 3: Finance constraints to Kosovar SMEs**



<sup>12</sup> Source: RIINVEST, EAR-WB

Enterprise owners and managers are relying primarily on informal sources of financing; only 3 percent reported using formal sources. The respondents reported that the most important source (74 percent) was own funds, followed by friends and relatives (42 percent) and supplier credit (17 percent). Moneylender, donors and NGOs, and others were each mentioned by 5 percent of the respondents. The team's informal survey confirmed this pattern; all of the indicated that they had reactivated their business "on their own," using family savings, remittances, and funds obtained from family and friends.

### ***Loan demand***

There are several ways of trying to get a better idea of the characteristics of loan demand. One option is to derive financing needs from the required replacement of existing assets as well as working capital requirements. Exhibit 4 shows information on current assets for small and medium-sized enterprises. The annual financing needs were derived by assuming a five-year replacement schedule for fixed assets (81 percent of managers responded that their equipment was over five years old), and working capital requirements equal to 40 percent of inventory. Managers interviewed estimated that replacement or modernization of equipment would cost on average DM 389,000; this higher figure is likely to reflect the greater needs in the immediate time frame. A significant majority said that they could not meet current demand due to inadequate, outdated or damaged machinery.

**Exhibit 4: Investment needs — Fixed assets and working capital**

	Fixed assets		Inventory/working capital needs	
	Current	Investment needs	Inventory	Working capital
Small firms	DM 265,000	DM 54,000	DM 56,000	DM 22,000
Medium-sized firms	DM 835,000	DM 167,000	DM 212,000	DM 84,000

The World Bank assessment also provided a breakdown of loan demand by loan size:

**Exhibit 5: Reported loan demand by loan size**

Loan amount DM	Percent of firms surveyed	Percent > lower limit
Less than 20,000	20	
20,001 - 50,000	20	80
50,000 - 100,000	21	60
100,000 - 400,000	25	39
Over 400,000	14	14

Thus, 60 percent of the firms surveyed reported a demand for loans in excess of DM 50,000. In addition, all of the firms surveyed indicated that they would apply for loans if funds were available.

Yet another approach to assessing credit demand is to look at historical trends in investment activity. Exhibit 6 shows aggregate and average investment for the period 1997 to 1999 by firms surveyed.

**Exhibit 6: Investments by firms surveyed for the period 1997-1999**

Year	Total amount invested (DM)	Percentage of firms investing	Average investment (DM)
1997	29,100,000	81	360,000
1998	22,500,000	68	330,000
1999	12,300,000	63	195,000

Average investment in the two years before the conflict thus is close to the investment needs (replacement and modernization) reported by the managers interviewed in the World Bank-sponsored assessment (DM 389,000). The average investment figures also reinforce the earlier conclusion that demand for loans in the range of \$50,000 and above is significant. However, in the team's informal survey of enterprises in the center of Pristina, all but one of the businesses expressed a demand for credit, mostly in the range of DM 10-20,000, for working capital as well as for equipment and new or expanded locations. This result would suggest that the market for credit is not only not saturated; it has not even begun to be covered.

**Conclusion**

The picture that emerges from these numbers is clear: there is significant unmet demand for credit, with most needing credit in excess of DM 50,000, although indications are that the demand for loans below that level is far from being satisfied. Fully 84 percent of the businesses surveyed said that access to credit was their overriding constraint in developing their full market



potential. Similarly, enterprises lack access to needed financial services for conducting normal business transactions.

## Financial services

### *The banking sector*

Kosovo's financial sector is in its infancy. Only one bank is currently in operation, targeted at the micro and small level, although others are poised to begin operations. A number of other lending programs have been established; however, disbursements to date have totaled less than \$3 million in aggregate, and these have targeted primarily either micro or small businesses. Annex B provides an overview of characteristics of selected microenterprise lenders, existing credit sources, and banks for which registry is pending.

#### In operation: The Micro Enterprise Bank

The only bank fully licensed and actually operating in Kosovo is the *Micro Enterprise Bank (MEB)*. The MEB is owned by a group of German investors, including Commerzbank, FEFAD Foundation-Albania, FMO, IMI and MEB-Bosnia. IPC, a German firm with an excellent track record worldwide with its specialized technology for small and medium lending, is in charge of all the managerial and technical operations of the bank. MEB is off to a very strong start, in large part because it is a foreign bank and thus presents a clear image of credibility, meaning security for depositors and seriousness for borrowers. In addition, two of its main owners bring excellent technical expertise: Commerzbank in all aspects of traditional banking, and IPC with worldwide experience in the forefront of microfinance.

The most notable feature of MEB is the large amount of deposits that it has captured, DM 80 million by late June 2000, almost without trying. These deposits are almost all in checking accounts paying no interest, with about 10 percent in time deposits and nothing in savings deposits because such accounts have not yet been promoted. There are now more than 9,000 checking accounts, with about 100 new ones being opened each day. Thus, even without savings products tailored to the market (except that checking accounts have no minimum balance for opening), it has been very easy for MEB to capture deposits because of an image of security. Deposits also dwarf MEB's 120 loans amounting to DM1.4 million. Repayment rates stand at 100 percent. MEB so far makes all its loans from its capital and transfers its deposits to Germany where they are placed in totally safe instruments but nonetheless earn a good spread (about 3 percentage points).

MEB targets micro and small businesses as clients, with initial loans typically in the range of DM10-15,000, but ranging from as low as DM2,000 to as high as DM50,000, with a tenor between six months and one year, and an interest rate of 2 percent per month. Reportedly, MEB is using the spread earned on its deposits to subsidize its lending. While the outreach (number of clients) is still small, IPC traditionally follows an aggressive expansion strategy. Given this fact, a strong demand for credit and a virtual monopolistic position in the formal financial sector, it could be expected that MEB lending operations would grow rapidly.

Although its lending is likely to be highly successful over time, the main initial lesson from the MEB experience is the huge demand for deposit services. In fact, MEB poses something of a threat in that might become increasingly difficult to compete with MEB for deposits the

longer it maintains its deposit monopoly. To be sustainable, any bank needs to be an effective mobilizer of deposits to have adequate funds to lend, so that any serious barrier to deposit mobilization threatens both side of the balance sheet, loans as well as deposits.

### Domestic banks

Six other commercial banks have been granted preliminary approval by the BPK but their start up date remains uncertain: EKO Banka, Banka Ekonomike; BankKos, Mortgage Credit Bank, Banka Kreditore and Trading Bank of Kosovo. In general, the business plans of the six banks define the small and medium size enterprise as their main lending target. Given the absence of large privately owned enterprises the market selected is more a reflection of the current composition of the private enterprise sector than an actual commitment to service the sector. Two of the six banks, Banaka Ekonomike and BankKos, although registered as new, were in operation until 1990.

*Banka Ekonomike* continued to operate during most of the 1990s on a small scale and, because it was Albanian owned, lent only to small enterprises in the private sector. The directors planning to re-open the bank also reported that it has no liabilities because it returned all money to depositors late in the 1990s. Among its assets are the buildings where it had branches, although some of these were destroyed during the war. It is also owed money by various former borrowers which the directors report are willing to pay but do not have the money to do so. While it is not totally clear, the directors may be relying to some extent on these old (and dubious) assets for some of the capital to re-open the bank. Re-opening of the bank was being delayed by slowness in receiving promised capital contributions and also by lack of equipment including computer hardware and software, but the directors nonetheless hope to re-open by September 1, 2000. It will be staffed by 42 individuals, all of them previous employees of the bank, and will try to re-open as many of its nine former branches as quickly as possible. The directors reported that they plan to offer credit to former clients, about 6,500 privately owned small businesses, but they were much less clear about the bank's potential for capturing deposits, either how much or who the depositors might be.

The *Bank of Kosovo (BankKos)* is also a pre-existing bank, but in this case it was a government-owned bank under the old regime and thus has not operated for about ten years. The president of the old bank, who is also the key person in re-opening the bank, reported that in those days the clients of the bank were primarily government-owned enterprises, but that the bank had considerable independence in decision making because of the prestige of its leadership and the importance of their international connections. He also reported that the bank still controls all the buildings where it had its main branches and its head office (except for one in Pristina that was destroyed) and plans to re-open all of these right away (and he mentioned another twenty which may have been sub-branches that were also to re-open soon). As a counterweight to these assets, he also mentioned that the bank had various outstanding claims against it from the old days that had not been resolved. The bank plans to begin with a staff of 270, all previous employees of the bank (it had 1,200 before 1990). Re-opening of the bank will occur as soon as more of the required capital contributions are collected. Its main clients for loans will be the enterprises that are to make the capital contributions, and he also reported that the depositors are likely as well to be these and other enterprises rather than individuals.

## Prospects for foreign banks

The *American Bank of Albania (ABA)* has indicated its interest in establishing a branch in Kosovo.

*Shorebank* is an obvious candidate for a foreign bank to enter the Kosovo market. According to Shorebank itself, "Shorebank programs have delivered the overwhelming majority of such small business credit supported by U.S. foreign assistance funds in the region." (Proposal for Trans-Caucasus Small Enterprise Financing Program, September 2, 1998, p. 1) Reviewing this document, together with the project's Quarterly Report for March 2000, reveals that Shorebank with its partner FINCA have disbursed almost \$8 million in the approximately two years since the start of the project, including slightly more than \$1.5 million in the most recent quarter. Of this, a clear preponderance of credit has been disbursed in Georgia, followed by Azerbaijan, with relatively little in Armenia, although these latter two were about equal in the most recent quarter (between \$200,000 and \$300,000). While total disbursements have amounted to almost \$8.0 million, the actual amount of credit outstanding at the end of March 2000 was just over \$3 million, of which over \$2 million was in Georgia, just over \$500,000 in Azerbaijan and about \$300,000 in Armenia.

Shorebank's Quarterly Report provides little information on loan repayments. The one table presented on portfolio at risk (p.3) shows higher arrearages for countries and programs with greater amounts outstanding, and these percentages are higher than for sustainable microfinance programs in other parts of the world. Without information about possible refinancing and restructuring of loans, it is impossible to make a serious assessment of the quality of the loan portfolio. Nonetheless, higher arrearages associated with larger amounts outstanding may suggest problems with loan management, lending technology or both, to the extent that programs cannot expand without compromising portfolio quality. It would also be important to know the number of new borrowers compared to repeat borrowers, as well as the number of borrowers repaying and not requesting new loans (desertion) in order to judge the quality of lending services. There is likewise little discussion in the Quarterly Report of sustainability, and only one set of tables where pertinent information is presented, and this shows that operational self-sufficiency is only slightly over 30 percent in Azerbaijan and Armenia, but around 80 percent in Georgia. Finally, there is no discussion in the Quarterly Report of deposit mobilization by banks or other financial institutions but only of resources mobilized from other donors.

## **Microfinance institutions**

Six microfinance NGOs have registered with the BPK and are actually serving the micro, small and medium enterprise sector: Finca Kosovo, Mercy Corps International (MCI), International Catholic Migration Committee (ICMC), Malteser, Solidarites, and Grameen Trust. In addition, CORDAID, a Dutch NGO, operates a pilot "rural bank," as discussed further below. With the exception of the Grameen Trust, they all have started lending operations although in a very small scale. Annex B summarizes the main program features including target population, geographic areas served, terms and conditions, as well as statistics on number of active clients, portfolios and average loan size. Most NGOs target the micro and small entrepreneur through group lending schemes such as solidarity groups (ICMC) and village banking (Finca, Grameen Trust).

Other institutions use individual lending to target the largest enterprises (MCI and Finca SEL program). Loan sizes range from DM 500 (Finca, Grameen) to DM 2,000 (ICMC) for first

loans under group lending and from DM 2,000 (Finca) to DM 50,000 (MCI, Solidarites,) under individual lending. Subsequent loans scale-up to a maximum of DM 10,000 to DM 30,000 under group lending and up to DM 90,000 (MCI) for individual lending. MCI, Finca, Grameen and ICMC charge flat interest rates ranging from 1.25% to 1.5% a month. Finca charges 2% a month on the declining balance under the small enterprise lending (SEL) and 1.5% flat per month under the village banking. Loan terms are short for most programs. Working capital loans have terms no larger than 12 months (MCI) under individual lending and 4 to 8 months under group lending. Finca, Grameen and ICMC operate mainly group guarantees. Nonetheless, the individual lending programs of MCI and Finca use equipment, property and guarantors as collateral. Payments are made in weekly, bi-weekly and monthly installments of capital and interest.

Program outreach in so far has been limited, in part because most institutions started lending operations this year. As of June 16, 2000 and after six months of operations, Finca, the NGO with the largest outreach, has a total of 124 active clients, 107 under Village Banking and 17 individual loans under SEL. The outstanding portfolio amounts to \$141,737 with an average loan of \$757 under VB and \$6,062 under SEL. Repayment rates stands at 100 percent for both programs. Overall, the number of clients is in the hundreds, which contrasts sharply with a potential demand from 5,000 small and medium enterprises already registered with UNMIK and an estimate of 15,000 micro, small and medium enterprises not (yet) registered.

Among the microfinance NGOs currently in operations Finca Kosovo shows the highest potential for success. Finca, started operations in January this year in the city of Prizrim with two main programs: village banking and the Small Enterprise Loan program (SEL). The institution is an affiliate of Finca International, an American NGO that has developed and implemented worldwide a women-focused group lending technology called village banking. This technology has been proven successful in reaching microentrepreneurs in large numbers while achieving high repayment rates. Thus it could be expected, as it is in regard to MEB and the IPC technology, that the program will succeed in Kosovo as well.

## ***Interest rates***

Interest rates charged on loans by the few established lenders are in excess of 20 percent per year, and not just for microenterprises, but for SMEs as well. These rates reflect in part the high credit risk present in an environment where: ownership of most tangible assets is not only unclear, but often contested; there is no mechanism to perfect a lender's security interest in any kind of property; the identity of borrowers can generally only be verified by witnesses; the judiciary is not yet capable of hearing, let alone settling or awarding judgments on commercial litigation; and there is no reliable financial information on borrowers and/or guarantors. These factors force increased reliance on microlending techniques, even for SMEs. Such techniques, even when carried out efficiently, raise of course transaction costs because of the need to secure information that can take the place of traditional contracts and guarantees.

The lack of formal competition that generally results from a well-developed financial system also helps explain the high interest rates. In Kosovo there are two systems working side by side: the formal sector, which consists of just one bank and five semi-formal MFIs, small and with few branches; and the informal sector, based on emigrant remittances and accumulated

family savings, which may find their way into lending patterns restricted to family members and trusted friends, and perhaps sometimes to outsiders through professional moneylenders.

The problem of high interest rates for loans should not be addressed through statutory limitations on interest rates or usury laws. The market will take care of that problem, as soon as the general public has enough depository institutions to attract their savings, and those institutions, supported by an improved legal infrastructure, feel more confident about the level of risk in their loan portfolios.

### ***The World Bank's proposed line of SME credit***

The World Bank is currently processing, jointly with the European Agency for Reconstruction (EAR), a grant of DM 15 million for a credit line for small and medium scale enterprises (SMEs), complemented by DM 5 million for institutional development. It is expected that loans to SMEs under the credit line would range from DM 100,000 to DM 300,000, with an average of about DM250,000 and the possibility that follow-on loans might be as large as DM 500,000. The World Bank believes that this range of clients (loan sizes) is unlikely to be served by the existing bank (MEB) or MFI/NGOs, all of whom appear to be targeting smaller scale clients. However, given uncertainty about the effectiveness of guarantees and contract enforcement possibilities under present circumstances in Kosovo, it may be necessary to use microlending technologies. It may therefore be ill-advised to start with loans as large as DM 100,000.

The key element for implementation is the creation of an Interim Credit Unit (ICU) that would initially retail loan funds directly to SMEs, then wholesale funds to banks licensed to operate in Kosovo for on-lending to SMEs, and ultimately disappear. This approach offers an innovative solution to a difficult situation in which there appears to be a significant demand for credit by SMEs, but where few institutions are qualified to lend sustainably to this clientele, and none on a significant scale. In order to begin disbursing in the short run, there is little choice but for the ICU to act as a retailer. What is innovative is the shift to wholesaling as rapidly as possible and, even more so, the termination of the ICU at the end of the project, based on the desire of the World Bank not to leave behind the possible seed of a state-owned development bank.

The World Bank is clearly cognizant of the risks inherent in this innovative approach. Receiving greatest attention are the potential difficulties of a viable exit strategy, in disposing of the loan portfolio at the end of the project as the ICU is terminated. On the other hand, the World Bank seems less aware of potential difficulties in the ICU's transition from retailer to wholesaler. The difficulties of transition are partly a technical matter: retail lending to SMEs and wholesaling to banks for on-lending to SMEs each require different skills and techniques. But there is also the potential of conflict between the ICU as retailer and the banks to which it wholesales, as they may end up competing for the same SME retail clients. Such conflicts are not just hypothetical but can be found in almost every case where a financial institution acts simultaneously as both wholesaler and retailer. The appropriate response is to keep the transition period during which the ICU acts as both retailer and wholesaler as short as possible.

Because of the participation of EAR in this initiative, the entity being selected to administer the ICU will be European. It is likely to be the consulting arm of a major European bank, which would provide both the expertise and credibility required. This management entity will not only manage the ICU but will also provide training and technical assistance to

participating financial institutions. However, a limitation is that participating financial institutions can only be banks licensed to operate in Kosovo, thereby eliminating the possibility of participation by MFI/NGOs. This is regrettable, since relying on banks for on-lending tends to reduce their incentives for deposit mobilization. This disincentive would not matter in the case of MFI/NGOs because they are not licensed to capture deposits anyway. Moreover, in the case of Kosovo, MFI/NGOs are required to register with the BPK and to submit financial information on a regular basis. The opportunity of securing wholesale funds from the ICU could add a real incentive to meeting this requirement and thereby help to ensure the provision of transparent and credible information.

An unusual limitation of the project is that interest rates are predetermined, not only from the ICU to the wholesaler but also at the retail level, whether the retailing is done by the ICU or by participating banks. Setting of interest rates at the retail level is generally against World Bank policy but is justified in the present case by the lack of any true market rate at the retail level. In addition, the rate is to be adjusted — perhaps decontrolled — as market conditions develop.

### ***Agricultural credit through marketing intermediaries***

Agriculture presents its own problems and opportunities with respect to business finance and development. In this respect, a report prepared by the International Fertilizer Development Center (IFDC)<sup>13</sup> makes three points:

- (1) there is already a growing group of agricultural input suppliers that will be demanding increasing amounts of credit to finance their activities (such as credit for inventories);
- (2) there are significant numbers of agricultural processors that will be demanding substantial amounts of credit to restart or expand their businesses (such as credit for equipment and working capital); and
- (3) availability of credit from these marketing intermediaries may be among the best ways to increase access to credit for small and medium scale farmers on an effective and efficient basis, as compared to having banks and other financial intermediaries attempt to lend to them directly.

While the first two points are helpful in delineating the extent and type of credit demand; the third point carries considerable weight. In almost all countries, even those with strong banking systems and financial markets in general, agricultural input suppliers and purchasers of outputs continue to be among the main suppliers of credit to agricultural producers, including even medium and large scale producers.

According to the IFDC report, CORDAID,<sup>14</sup> a Dutch NGO, established a pilot “rural bank” to serve members of the agricultural trade association in Gjakova. It has disbursed \$265,000 to 12 members of the association to finance their trade at an interest rate of about 1 percent per month, and plans to provide \$2 million in revolving credit for agribusinesses. In addition, IFDC hopes that proceeds from USDA and EU sales of feed grains can be used to

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<sup>13</sup> Project Completion Report, May 31, 2000.

<sup>14</sup> Catholic Organization for Relief and Development Aid.

establish revolving credit funds aimed at stimulating agribusiness growth. The approach to be followed in the future is further elaborated in IFDC's proposal for a Kosovo Agribusiness Development Program presented to USAID (March 17, 2000), to use trade associations to transfer credit to farmers.

While there is merit to the statement that "providing credit to creditworthy agribusiness is far more efficient than direct lending to farmers and less risky for banks and financial institutions" (p. 4 and p. 23), the mechanism to be used raises serious concerns. Specifically, IFDC proposes to provide expertise in credit applications to members of the trade association and subsequently offer financial counseling and liaison with banks. This will make it very difficult for CORDAID's revolving fund, or the bank that it is planning to establish, to reject such credit applicants. In addition, IFDC hopes that association members will invest in the bank, which would create further potential for conflicts of interest, as in the case of bank lending to related parties that has proved so problematic around the world and especially in countries formerly based on central planning. Finally, CORDAID is planning to charge an interest rate lower than MEB, whose rate is already thought to be subsidized by profits from deposit operations.

In order to implement what is potentially an excellent idea — access to credit for small and medium scale agricultural producers through marketing intermediaries — three key elements should be taken into account:

- (1) implementation of lending to marketing intermediaries (including pure traders as well as sellers of inputs and processors of agricultural outputs) by a financial institution that has an *arm's length* relationship with these potential borrowers and that understands how to evaluate this type of credit primarily on a cash flow and character basis (though not neglecting guarantees when these can be effective in the Kosovo context and not too costly);
- (2) some assurance that association members and other marketing intermediaries that are potential lenders are fully aware of the risks and rewards of lending to farmers and, in the absence of such an assurance, training and technical assistance to introduce best practice technologies for this type of lending; and
- (3) overall policies and practices to ensure that trade associations do not develop monopoly elements with respect to access to credit (or in general).

## Business development services

As noted above, critical business skills, such as accounting, and experience in running businesses in the more complex, highly competitive, and market-driven international arena are in short supply in Kosovo. Several organizations are currently addressing these constraints, albeit in a limited fashion. Other programs are in the planning stages, so their impact cannot be evaluated at present. None of the programs, however, appear to address the specific skill needs of the SME sector in a broad and comprehensive way.

Mercy Corps International operates a Small Enterprise Development Program in the Peja region that makes business plan training a requirement for its loan application process. The training focuses on small business and reflects its maximum loan size of DM 100,000. Through the training program businesses are given personalized assistance in the planning and loan

application processes. Because of this intensive approach training costs are high, and the program to date has limited geographical reach. Mercy Corps is also hampered by limited amounts of funding.

FINCA is also active in Kosovo's private sector. It delivers training in a similar way, providing one-to-one assistance in the loan application process. Its efforts to date have been focused on the micro and small business sectors in addition to village-based lending and support.

The Kosovo Chamber of Commerce has conducted training on a limited scale by sponsoring seminars with counterpart chambers in the region. However, the programs do not appear well organized or focused, and it is unclear how the chamber's wider membership benefits from these seminars.

Cap Espoir is a consulting firm currently funded by the Dutch Development Agency. The firm works particularly closely with CORDAID in the Paja region and provides business plans for companies seeking outside funding. The company has recently begun training seminars focused on specific subsectors such as woodworking. Operating with limited resources, Cap Espoir has initiated a number of important support activities, including a database of SME firms in the Paja region. However, its main accomplishments to date have been limited to assisting returning refugees' startup microenterprises.

The World Bank is looking to the yet-to-be-established Balkan Enterprise Fund to implement its business assistance activities. The exact scope of the Fund's activities are not known at this time. The Fund is currently focusing its energies on a pilot program in Croatia, so its near-term impact on Kosovo is expected to be minimal.

Other business support activities are underway or planned in Kosovo. Again, however, they appear to be limited in scope or not directed at the immediate-term needs of the SME sector. GTZ plans a vocational training program, which would include an overseas component, but it is still in the early planning stages. UNMIK is providing technical assistance to large, state enterprises with the intent of separating those enterprises into stand-alone businesses to be run under management contracts until ownership can be established. UNMIK is also creating databases of firms operating in various sectors, but that effort is hampered by slow registration of firms and the inaccuracy of data.

## **Options for USAID intervention**

### **Business finance**

#### ***Options and criteria***

With respect to potential USAID interventions to strengthen finance services for Kosovar businesses, the RFP identified seven principal options:

- the setting up of a separate legally self-contained SME financing facility;
- the operation of an SME credit facility through a licensed commercial or development banking institution;



- the setting up of a rediscount line-type financing facility for use by eligible licensed commercial banks;
- development of a loan guarantee facility;
- the utilization of donor financial and/or technical resources to attract a viable regional or international banking institution into Kosovo;
- the establishment of an equity fund to provide venture capital to fledgling private entrepreneurs; and
- the utilization of seed capital to attract reputable international or regional investors to set up and operate an equity fund-type operation in Kosovo.

Three principal conclusions based the team's field work define the framework and criteria for exploring and assessing these options, along with certain variations and additions:

- Because of the absence of legal infrastructure, particularly with respect to possibilities for enforceable contracts and loan guarantees, lenders will need to rely on microlending technologies even for loans that are much larger in amount than traditional micro loans. Using traditional bank lending techniques for small and medium enterprises is almost certain to result in poor borrower selection and very poor loan recovery.
- The credit market is not saturated even for loans in the size range of traditional microlending.
- The situation in Kosovo is highly uncertain. The financial system is just now beginning to evolve and will undoubtedly move in directions that at times will provide significant surprises. Given that existing constraints are on the supply side and not on the demand side, any USAID interventions should not only focus on strengthening financial institutions but should also have a variety of options and the flexibility to readjust among these options.

## ***A self-contained financing facility***

### **Cooperation with the World Bank's ICU**

An example of the first of these options is already being implemented by the World Bank (and EAR) through their ICU to make retail loans to SMEs in the range of DM100-300,000 (and possibly as high as DM500,000), then to do wholesaling to the same types of clients through licensed banks, and finally to liquidate the ICU. Thus, an option for USAID would be to join this institution, which is designed to phase out as quickly as possible (although the exit strategy still needs clarification). USAID's possible participation with the World Bank and EAR through supplying additional funds to the ICU, could help expand the range of ICU's activities in two important respects. Specifically, it could make it possible to make smaller loans to SMEs, and to include not just banks in retailing but also MFI/NGOs.

Thus, to participate USAID would need to ensure that two important conditions were present:

- (1) that loans could start smaller than DM 100,000, even though DM 100-300,000 is the ultimate target, because of the need to start smaller and escalate loan sizes as a key part of any microlending technology that would need to be applied; and

- (2) that qualified NGO/MFIs would also be eligible to participate as retailers for wholesale funds for three reasons:
  - they could increase competition and outreach in a situation where there are very few eligible institutions;
  - they are already being registered and monitored by the BPK and potential assess to wholesale funds could increase incentives for compliance and for greater transparency; and
  - access to wholesale funds inevitably reduces incentives for deposit mobilization, which is a problem for banks but not for NGO/MFIs that cannot legally capture significant amount of deposits in any case.

The main disadvantage to USAID is that it would not have an institution (the ICU), and hence a project, whose accomplishments could readily be attributed. There will undoubtedly be some general administrative struggles among the various contributors to the ICU and perhaps some specific conflicts about using non-bank financial institutions as retail outlets and about making smaller loans.

In any case, USAID's project would presumably maintain a separate unit that would provide training and technical assistance to both banks and non-bank financial institutions to improve their lending capabilities (and deposit taking in the former case) and to enhance other aspects (such as management information and control systems) to move them more rapidly toward sustainability. This would provide USAID with key leverage based on the quality of its training and technical assistance. In addition, USAID could fund the ICU incrementally and thereby leave open the possibility of providing grants directly to banks (both US and Kosovo) that offer the potential of serving the SME and micro markets in Kosovo sustainably or to promising MFI/NGOs that might upgrade to banks.

### A new institution

However, working inside the ICU may entail certain disadvantages that could not be compensated by the fact that the ICU already exists. Among these disadvantages is the possibility that USAID would have little control over the institution; moreover, the capabilities and focus of the entity to be chosen to run the ICU are unclear. In addition, the ICU as constituted by the World Bank (and EAR) is unlikely to give the kind of attention to deposit mobilization that the team believes is required. If USAID is not able to negotiate an acceptable arrangement with the World Bank (and EAR) to work within the ICU that addresses these weaknesses, it could create its own similar institution. Such an option would have the needed potential for increasing funding and institutional capacity in a situation where both are clearly lacking.

The core element of such a new lending institution is a Technical Unit (TU) that will act as the project's umbrella and have three main functions:

- (1) Retailing/wholesaling loan operations
- (2) Managing and awarding a grants component
- (3) Technical assistance in the development and implementation of small and medium lending as well as savings products.

Two important caveats must be kept in mind:

- having an institution doing both wholesale and retail lending inevitably results in conflicts of interest between the wholesaling institution's retail operations and the retail operations of the lenders to which it wholesales, so that the transition period from retailer to wholesaler should be as short as possible; and
- retailing and wholesaling require very different lending technologies even though the ultimate clientele is the same, so that substantial technical assistance will be required for the unit, whether it is the ICU or a distinct unit to be created by USAID.

### *Retailing/wholesaling loan operations*

A major function of the TU is to act as retailer for project funds, lending to a full range of private enterprises in Kosovo but especially to SMEs. Under this role, the TU will not only develop and implement lending products but will thereby become a focus for the demonstration of know-how on lending techniques. The loan retailing function will be the main focus of the Unit during this first phase until one or more lending institutions are identified with both the capacity and willingness to take over such lending operations. Concurrently, the TU will look for one or more formal financial intermediaries that can also undertake SME lending and will assist with the implementation of appropriate lending techniques but especially with deposit taking techniques that are appropriate for the local context. Once this phase is completed, the Unit will assume a wholesaling function, provided that an assessment of results so far and the availability of financial services for the SME sector indicates that wholesaling of funds in a necessary function. Specifically, wholesaling operations during this second phase for the TU as lender may be particularly important if the assessment identifies the expansion of lending services to the target sectors as being curtailed by lack of funding. This may well be the situation for MFI/NGOs that are not legally authorized to mobilize savings.

### *Technical assistance with lending and deposit mobilization products and services*

The technical assistance component of the Unit has the main function of transferring lending and deposit mobilization technologies. The transfer of lending technologies would include all aspects of loan delivery: terms and conditions, promotion, application, analysis (character and cash flow based techniques), approval, disbursement, monitoring and recovery, as well as all aspects of loan management including management information systems, and audit and internal controls appropriate to SME lending. The transfer of savings mobilization techniques would include: design of savings products to serve rural markets and small depositors (the main market in Kosovo), cost assessment and profitability analysis, monitoring techniques, customer service and quality control.

Specific products of the technology transfer component of the TU would be manuals for each lending and savings product, implementation plans, target definition, and the definition of all indicators to monitor profitability, outreach and quality of service and consumer satisfaction. The technical assistance will be oriented primarily to formal financial intermediaries, although MFI/NGOs will be assisted with lending, and possibly with savings should one or more of these institutions become interested in transforming to become a formal financial institution. Technical assistance will be closely coordinated with the grants component (see below) and focus

on the local or foreign institutions identified that show not only the willingness but also the managerial capacity actual to serve the target market.

### *Managing and awarding the grants component*

Closely linked to the lending operations and to the technical assistance component will be the grants component. Managing and awarding grants has three main functions:

- (1) to identify and attract local or foreign banks interested in becoming involved in the provision of financial services to the target clientele in Kosovo;
- (2) defining, in conjunction with USAID, the terms and conditions for participation, eligibility criteria for selection, and the approval process and rules; and
- (3) organizing forums and seminars to attract applicants by demonstrating the potential of providing financial services in Kosovo profitably.

In all likelihood, there would be two main types of grants: large grants (perhaps \$ 1 million or more) to attract foreign financial institutions to the Kosovo market; and smaller grants (perhaps as little as \$ 50,000) to assist existing financial institutions, either banks or MFI/NGOs, in expanding outreach to the target clientele by opening new branches or acquiring equipment such as computer systems. As noted above, grants would be closely coordinated with technical assistance for the recipients and with the wholesaling of funds (grants would not be used for on-lending).

### *Staffing of the Technical Unit*

For the first year, the staff of the Technical Unit might comprise the following positions:

- Chief of Party: long-term senior expatriate with substantial microlending expertise (bank operations and strategic planning experience would also be desirable) to take overall responsibility and to work with retail lending and with technical assistance as needed;
- Micro/SME lending specialist: long-term mid to senior level expatriate with microlending expertise to run retail SME lending operation in conjunction with COP and to provide training and technical assistance to SME lenders;
- Loan Origination Specialist: long-term mid to senior level expatriate with microlending expertise to assist in identifying borrowers prospects and in helping the most promising ones to develop business plans for loan structuring;
- Deposit Mobilization Specialist: long-term mid to senior level expatriate with experience in deposit mobilization targeting small-scale and rural clientele to provide training and technical assistance to foreign and local banks (and help with MFI/NGO transformation);
- Commercial Bank Operations and Strategic Planning Specialist: long-term senior level expatriate to assist in locating foreign bank and assisting with start up and to provide technical assistance to local banks (and to MFI/NGOs wishing to transform);
- Management Information Systems Specialist: short-term (6 months) mid to senior level expatriate with experience with financial institutions and with computer systems to provide assistance to foreign and domestic banks and to MFI/NGOs;

- Internal Audit and Financial Controls Specialist: short-term (6 months) mid to senior level expatriate with experience with financial institutions to provide assistance to foreign and domestic banks and to MFI/NGOs;
- Local technical staff: to work in each of the above areas: 3 microlending and one each in deposit mobilization, bank operations, management information systems, internal audit and financial controls; they need to have some English and to be flexible and eager to learn, with prior experience in the area desirable but not required;
- Local support staff: administrative assistant (needs English), 2 assistants, 2 interpreters, 2 drivers.

## ***Other options***

### **Credit facility operated by a licensed financial institution**

The second option listed in the RFP, the *operation of an SME credit facility through a licensed commercial or development banking institution*, is inferior to the first option for the simple reason that only one licensed bank exists, MEB, which would certainly not be interested in participating with a USAID project because it already has more than ample support from its German partners. However, as discussed below, the option of attracting viable international banking institutions into Kosovo is one that should be pursued.

### **Rediscount line**

The third option, the setting up of a *rediscount line-type financing facility* for use by eligible licensed commercial banks, has basically the same limitations as the second option when compared to the first: there is at present a lack of banks to be conduits for these rediscounts, nor did the team find any of the local banks with provisional licenses that were likely to be in operation in the near future.

Consideration of the second and third options makes clear the relative advantage of the first option in potentially providing almost immediately a new retail outlet for lending to SMEs, with the potential to shift to wholesaling of funds as eligible retail institutions emerge.

### **Loan guarantees**

The fourth option, development of a *loan guarantee facility*, is one that should not be pursued now, and probably not in the future either, at least in the form that loan guarantee facilities are usually conceived. The present situation in Kosovo is one in which financial intermediaries (lenders and deposit takers) are the key lacking element, the legal infrastructure is not in place for loan guarantees, and none of the lenders now or potentially operating in Kosovo has expressed to the team an interest in loan guarantees. Moreover, at least one member of the team has done an analysis of loan guarantees on a worldwide basis, together with in-depth analysis of loan guarantee arrangements in specific countries. The main findings are that government and donor loan guarantee schemes are not market based, complicate relationships between borrowers and lenders, thereby adding to administrative costs, and diffuse responsibility for loan recovery, thereby adding to loan recovery problems. More specifically, there are no cases where additionality can be attributed to loan guarantees; that is, no borrowers can be identified who would not have received loans anyway. In addition, all government and donor loan

guarantee schemes examined in depth have been found to lose money, but this is often covered up by the earnings on investments from the capital contributions that are typically used to set them up. Successful loan guarantees were found only at the wholesale level (e.g., Accion International's programs) where the guarantee is for lending from a commercial source to an MFI/NGO whose solvency can be ascertained by traditional techniques of financial analysis of a financial institution. Such an arrangement could be studied for the future but would be premature in Kosovo at this time.

### Attracting a foreign bank

The fifth option, the *utilization of donor financial and/or technical resources to attract a viable regional or international banking institution into Kosovo*, should certainly be pursued as an alternative to setting up a *de novo* lending operation. The experience to date provides ample rationale for such an option:

- there is a huge unsatisfied demand for deposit services;
- the current situation is in effect a monopoly for one foreign bank that should be subject to competition as soon as possible; and
- the potential profitability from deposit taking should make it much more attractive for a foreign bank to enter the market than is normally the case when only SME lending is targeted.

Moreover, only a credible foreign bank can provide the image of security that will be required to mobilize deposits effectively in the short run. It will nonetheless be important to provide technical assistance in deposit mobilization to this foreign bank, not only because competition will not be easy given MEB's entrenched position, but also because products and services will need to be designed and implemented for the Kosovo market that are not typical for a foreign bank that will have the required credibility.

Of course, the foreign bank (or banks) to be attracted to Kosovo should be expected to do more than capture deposits; they should also be expected to lend to the target SME clientele. For a foreign bank to be interested in doing this, they must be also be convinced that this lending activity will be profitable. Moreover, as emphasized at the outset, SME lending in Kosovo must be based on microlending technologies because of the absence of traditional guarantees, contract enforcement mechanisms, and even credible financial statements in most cases. Thus, convincing a foreign bank that SME lending in Kosovo can be profitable is unlikely to be so easy, especially since very few foreign banks have serious microlending experience (some in Latin America, a few in Asia including especially the BRI's Unit Desas in Indonesia).

Although successful deposit mobilization will be indispensable, a foreign bank that enters the Kosovo market based solely on the profitability of capturing deposits is unlikely to pay more than lip service to lending to the SME market, no matter one kind of targets and monitoring arrangements are imposed. It will require a technical assistance and training unit at the heart of USAID's potential project that not only can teach microlending techniques but can also convince the foreign bank(s) that such lending can be profitable and, furthermore, has the capability of making or withholding incentive grants based on actual accomplishments. The requirements for such an implementation unit are discussed in greater detail elsewhere in this report.

Annex C presents an illustrative budget for a de novo financial institution, which would be pertinent to both options 1 and 5.

## Equity finance

The last two options, six and seven, are both related to *venture capital*:

- the establishment of an equity fund to provide venture capital to fledgling private entrepreneurs;
- and the utilization of seed capital to attract reputable international or regional investors to set up and operate an equity fund-type operation in Kosovo.

While venture capital and equity arrangements are potentially highly attractive options, the legal infrastructure is not yet in place for these options, in particular the development of a viable exit strategy. Moreover, larger enterprises (by Kosovo standards) of the size that would normally be of interest to most such investors are currently either in the public domain or of uncertain ownership. At the same time, enterprises demonstrably in the private sector are often found to be effectively owned by groups of family members, and in other parts of the world such family groups have proven particularly difficult for outsiders deal with. If additional options were to be considered by USAID, the team would think that leasing is potentially more attractive, but leasing is likely to require further improvements in the legal environment and to be carried out by the same banks and MFI/NGOs that would carry out SME lending. Leasing is thus an option that could readily be added in the future, the legal environment permitting.

## Conclusions and recommendations

Demand for financial services is not now an issue, nor is it likely to be for the foreseeable future. Thus, the constraints to expanding financial services are on the supply side. First, there are the legal and regulatory constraints that shape the business environment and therefore lending conditions for banking institutions. The noted weaknesses in legal and regulatory framework for business operations imply that microlending technologies must be used. Even for larger loans, traditional banking techniques must be used.

Given these needs and the issues associated with any temporary specialized lending operation, whether it is the World Bank's ICU or another similar operation set up under USAID auspices, USAID's should give priority to finding a bank willing to locate in Kosovo. This option could be pursued in parallel with support for a temporary lending facility, allowing it to phase out quickly and providing a suitable exit strategy. The (foreign) bank would focus on deposit mobilization, as well as lending, and would be willing to accept technical assistance to adapt its deposit products and services to the Kosovo market (even though it might be a highly effective deposit mobilizer in its home market). Only such a bank will be able to initiate effective competition with MEB for deposits and thereby break its monopoly. Moreover, for reasons of an image of security, the initial bank to compete with MEB for deposits must be a foreign one. However, neither of the two foreign banks that have been investigated so far appears to qualify.

Strengthening domestic banks would also be an important priority of any USAID intervention, but this is likely to be a longer-term task. First, no domestic banks have yet been licensed. Second, as noted above, for reasons of an image of security, a domestic bank cannot be expected to lead the way in breaking MEB's deposit monopoly, and in any case the domestic

banks in formation that were interviewed appeared to give little emphasis to deposit mobilization. Third, many of the domestic banks tend to have a view of lending that is all too typical of the region, and of formerly centrally planned economies in general: banks exist primarily to channel loans to the enterprises that own them. In fact, in the extreme case of one of the “old” banks for which the management was interviewed, investors were essentially buying two lottery tickets: the first to see if the value of the assets that the bank had once owned and hoped to control again exceeded the unresolved claims against it; and the second to see which potential borrowers owning shares in the bank might most quickly obtain a loan. Nonetheless, domestic banks should not be abandoned but should be approached initially with offers of training and technical assistance and only later with offers of strengthening grants or funds for on-lending in order to avoid obvious opportunities for rent seeking.

## Business development services

### ***Objective and approach***

The proposed activity will support USAID/Kosovo’s Strategic Objective 1.3: *Establishment of an Economic Policy and Economic Framework*. The explicit focus of the program will be on stimulating employment and increasing private investment in the SME sector, thereby supporting the rapid and sustainable recovery of living standards for the Kosovar population. It will support the reconstruction of the private economy and provide the opportunity to build upon the entrepreneurial capabilities and informal trade and financial networks developed out of necessity by the Kosovar Albanians over the past decade. The ***Kosovo Business Support*** component will contribute to the revitalization of businesses through:

- (1) a business services support element providing direct assistance and training in core elements of managerial and financial accounting, marketing and strategic planning; and
- (2) broader business support initiatives such as trade and investment, Internet provision of support, and pilot SME activities.

The Kosovo Business Support Program is projected to cover a three year period (10/01/00 – 9/30/03). During the first year of implementation it will include the following tasks:

- (1) Direct support to SME businesses (with priority to Kosovo Business Finance borrowers) for:
  - establishing managerial and financial accounting systems
  - developing business plans to guide operations and growth
  - developing trade and investment opportunities
  - operations support (primarily through providing PVO industry specialists)
- (2) Other umbrella business support initiatives, to include:
  - development and maintenance of a Kosovo trade and investment database (to be linked with other regional trade and investment networks and databases)
  - development of SME/sectoral associations



## ***Direct support to SME businesses***

### **Business planning and financial and accounting systems**

The purpose of the direct support activities is to provide to selected, “high potential” SME firms tools to enhance their growth potential. To achieve rapid, short-term impact the program will rely on existing organizations that have already identified firms with strong potential. UNMIK, Mercy Corps, World Bank, and CORDAID, to name a few, have identified such firms. They would then be screened further by several additional criteria: number of employees (greater than 10), years in business (greater than two), and revenue (in excess of DM 250,000). Site visits by experts, positive technical assessments, and an assessment of management strength would also play a role in the evaluation. Preference would also be given to perspective or current BFK clients. Initially, it will also be important that selected firms have access to computers due to the nature of the support to be provided. Because of the high concentration of firms in Pristina, Peja and Gjakova, support will be delivered in these areas initially. A fee will also be charged for the seminar and subsequent activities.

The first phase of direct support will consist of a three-day seminar run by business development specialists. The seminars are designed for 15 to 20 participants and will introduce basic concepts in marketing, finance, accounting, and business planning using a modular format. At the conclusion, participants will have a rudimentary knowledge of these basic skill levels.

More importantly, the seminars will make the second phase of the support, on-site follow up, more efficient. Lasting a week, the on-site visits will have the business development specialists working with key company personnel to install computer-based accounting and financial packages and developing action-oriented business plans. This phase will provide companies with the tools to obtain additional financing and track operations more effectively.

The on-site phase will be tightly managed by means of a scope of work agreed upon before the phase begins. In this way the activities of the business development specialists can be monitored and quantified. Should companies desire additional assistance, another scope of work will be developed and an additional fee charged.

As mentioned, this activity will rely on a network of existing organizations to recruit participants. Over time, the Program will develop its own contact database to supply new participants. The Business Finance component will also be an important source of new candidates. By the third year, the assistance being offered will be taken over by associations, local consulting firms, or former program employees.

### **Trade and investment and operations support**

During this second, on-site phase of the initial support program the business development specialists will assess companies as to potential for further growth through trade and investment activities or growth through additional technical (operations) support. The Program will then recruit technical experts from the PVO network work with those firms. Again, a scope of work will be agreed upon beforehand so as to insure timely completion of activities.

## ***Other business development initiatives***

### **Trade and investment database**

The program will establish a database of qualified Kosovo SMEs and link it with existing regional and international databases. The database will be established under the leadership of an expert hired by the project. However, it is assumed that project will work closely with existing organizations, particularly the Kosovo Chamber of Commerce and other nascent business groups, during its creation. Once fully functional, the database can be managed by the Chamber.

### **Development of SME associations**

The project will hire an expert with experience in organizing and establishing business associations. The expert will meet with existing NGOs, international agencies, and local businesses to identify business leaders who will assist in creating the associations.

## **Tangible results, benchmarks and performance indicators**

### ***Tangible results***

#### **Kosovo Business Finance**

Under the assumption of three-year time horizon for the proposed USAID intervention, the following tangible results are to be achieved. For the business finance component of the intervention, they are primarily defined in terms of disbursement targets, subject to high credit quality criteria in terms of default, arrearages and loan classification. The disbursement targets include the use of reflows, under the assumption of an average tenor of one year. The loans are also intended to be productive in term of the number of jobs generated, under the assumption that each DM 10,000 in loans generates one job:

##### ***Year One***

- 120 loans disbursed with average loan size of DM 63,000
- DM 7,600,000 disbursed
- Arrearage rate under 5 percent, and classified loans under 10 percent
- 760 jobs created

##### ***Year Two***

- 315 loans disbursed with average loan size of DM 87,000
- DM 27,500,000 disbursed
- Arrearage rate under 10 percent, and classified loans under 10 percent
- 2,750 jobs created

##### ***Year Three***

- 380 loans disbursed with average loan size of DM 110,000

- DM 41,450,000 disbursed
- Arrearage rate under 5 percent, and classified loans under 10 percent
- 4,145 jobs created

For the proposed three-year intervention, the expected aggregate results are therefore:

- 815 loans disbursed with average loan size of DM 94,000
- DM 76,550,000 disbursed
- 7,655 jobs created

### Kosovo Business Support

The tangible results for the business development support component of the proposed USAID intervention are defined in terms of specific services delivered to SME companies and the Kosovo SME sector in general. These services are expected to result in improvement in the performance of client SME companies evidencing improved performance as determined by employment growth, profitability improvement or revenue growth (not less than 10 percent) as follows:

#### *Year One – 60 companies*

- Direct support to SME businesses
  - 80 companies with improved managerial and financial accounting capabilities resulting from installation of project provided cost and financial accounting software systems
  - 120 companies with effective business/strategic plans in place to facilitate growth (of this no less than 40 start-up businesses)
  - 40 new trade and investment linkages established in magnitude of not less than DM 5,000,000
  - 20 companies with operations improvement strategies in place (developed primarily through PVO industry specialists)
- Business skills training, in conjunction with local institutions
  - 300 business managers/entrepreneurs to have gained basic business skills in areas of marketing, finance and strategic/business planning through having completed a 3 day training workshop
- Other umbrella business support initiatives
  - Kosovo SME sector to be provided greater opportunities for regional and trade and investment through a Kosovo trade and investment database
  - a stronger and more cohesive SME sector through establishment of regional and sectoral associations

#### *Year Two – 180 companies*

- 200 companies with improved accounting systems (software installed)

- 300 companies with effective business/strategic (120 start-up businesses)
- 80 new trade and investment linkages established in magnitude of not less than DM 10,000,000
- 30 companies with operations improvement strategies in Business skills training, in conjunction with local institutions
- 600 business managers/entrepreneurs complete basic business skills program

*Year Three – 360 companies*

- 300 companies with improved accounting systems (software installed)
- 400 companies with effective business/strategic (120 start-up businesses)
- 120 new trade and investment linkages established in magnitude of not less than DM 15,000,000
- 30 companies with operations improvement strategies in Business skills training, in conjunction with local institutions
- 900 business managers/entrepreneurs complete basic business skills program

For the proposed three-year intervention, the expected aggregate results are therefore 600 companies showing employment increases, profitability increases or revenue increases of not less than 10 percent:

- 580 companies with improved accounting systems (software installed)
- 820 companies with effective business/strategic (120 start-up businesses)
- 240 new trade and investment linkages established in magnitude of not less than DM 40,000,000
- 80 companies with operations improvement strategies in Business skills training, in conjunction with local institutions
- 1,800 business managers/entrepreneurs complete basic business skills

While approximate at best, the 600 Kosovo SME would have an aggregate revenue base of perhaps \$70 million with employment of 12,000 implying a substantive and sustainable impact when targets are met.

## ***Benchmarks***

All quantitative benchmarks for both business finance and business development services are cumulative.

### **Kosovo Business Finance**

Within 30 days:

- A comprehensive work plan to be approved by USAID
- A set of oversight procedures in place
- Application for a lending license filed

- Technical Unit established and staffed
- Potential domestic and foreign entities/banks to undertake establishment of business bank identified

Within 60 days:

- In conjunction with USAID, tender for interested banks/institutions to lead the formation of the business bank issued
- Budget and projected revenues established
- Framework operating procedures to ensure prudent operations established

Within 90 days

- Database of Kosovar companies with financial data and credit requirements completed
- Training of Kosovar staff in SME lending practices launched
- Operational structure, credit policies and procedures, loan follow-up and recovery policies, accounting systems, loan and collateral documentation, and oversight and audit functions established Lending Unit to become licensed and formally open drafted. Staff fully trained
- 50 business plans and loan applications prepared
- In conjunction with USAID, a partner bank/institution to form the business bank selected

Within 120 days:

- Contractual agreement with selected entity established ensuring proper representation, reporting and commitment to adhere to prudent lending activities as well as continue the activities of the Lending Unit
- Grant funding provided
- Completion of application for a full service lending license (support)
- Tenders for other business credit and business support activities/partners issued.

Within 180 days:

- Deposit gathering activities under way - minimum of DM 5,000,000
- In conjunction with USAID, likely candidates among other business credit and business support activities for grant funding selected
- 20 loans booked
- DM 1,000,000 disbursed
- 100 jobs created (cumulative)

Within 270 days:

- Deposit gathering - DM 10,000,000

- 60 loans booked
- DM 3,400,000 disbursed
- 340 jobs created
- Grant funding of other business credit and support partners provided

Within 360 days:

- Deposit gathering - DM 20,000,000
- 120 loans booked
- DM 7,600,000 disbursed
- 760 jobs created

Within 720 days:

- 435 loans booked
- DM 35,100,000 disbursed
- 3,510 jobs created

Within 1080 days

- 815 loans booked
- DM 76,550,000 disbursed
- 7,655 jobs created

## Kosovo Business Support

Within 30 days:

- A comprehensive work plan to be approved by USAID
- A preliminary database of potential clients established
- Local institutions identified for provision of training and business support services

Within 90 days:

- 10 companies with improved accounting systems (software installed)
- 15 companies with effective business/strategic (120 start-up businesses)
- 5 new trade and investment linkages established
- 2 companies with operations improvement strategies in business skills training, in conjunction with local institutions
- 25 business managers/entrepreneurs complete basic business skills program
- Website established
- Kosovo trade and investment database established
- Plan for establishment of SME/ sectoral associations developed

**Within 180 days:**

- 25 companies with improved accounting systems (software installed)
- 40 companies with effective business/strategic (120 start-up businesses)
- 12 new trade and investment linkages established
- 6 companies with operations improvement strategies in Business skills training, in conjunction with local institutions
- 75 business managers/entrepreneurs complete basic business skills program

**Within 270 days:**

- 45 companies with improved accounting systems (software installed)
- 75 companies with effective business/strategic (120 start-up businesses)
- 24 new trade and investment linkages established
- 12 companies with operations improvement strategies in business skills training, in conjunction with local institutions
- 175 business managers/entrepreneurs complete basic business skills program

**Within 360 days:**

- 80 companies with improved accounting systems (software installed)
- 120 companies with effective business/strategic (120 start-up businesses)
- 40 new trade and investment linkages established
- 20 companies with operations improvement strategies in business skills training, in conjunction with local institutions
- 300 business managers/entrepreneurs complete basic business skills program

**Within 720 days:**

- 280 companies with improved accounting systems (software installed)
- 420 companies with effective business/strategic (120 start-up businesses)
- 120 new trade and investment linkages established
- 50 companies with operations improvement strategies in business skills training, in conjunction with local institutions
- 900 business managers/entrepreneurs complete basic business skills program

**Within 1,080 days:**

- 580 companies with improved accounting systems (software installed)
- 820 companies with effective business/strategic (120 start-up businesses)
- 240 new trade and investment linkages established
- 80 companies with operations improvement strategies in business skills training, in conjunction with local institutions

- 1,800 business managers/entrepreneurs complete basic business skills

### ***Illustrative performance indicators***

- Number of loans disbursed during relevant period
  - to new clients
  - to existing clients
- Amount of loans disbursed during relevant period
  - to new clients
  - to existing clients
- Number of clients repaying in full during relevant period
  - asking for new loan
  - not asking for new loan
- Number of loans refinanced that were not paid in full during relevant period
- Amount of loans refinanced that were not paid in full during relevant period
- Number of loans outstanding at end of period
  - 1-30 days in arrears
  - 30-90 days in arrears
  - more than 90 days in arrears
- Total value of loans outstanding at end of period
  - Total value of loans with any payment 1-30 days in arrears (*not* the amount in arrears)
  - Total value of loans with any payment 30-90 days in arrears (*not* the amount in arrears)
  - Total value of loans with any payment more than 90 days in arrears (not the amount in arrears)
- Number of new deposit accounts opened during relevant period
  - Time deposits
  - Savings deposits
  - Checking deposits
- Amount of new deposits captured during relevant period
  - Time deposits
  - Savings deposits
  - Checking deposits
- Number of Deposit Accounts at end of period
  - Time deposits



- Savings deposits
- Checking deposits
- Amount of deposits at end of period
  - Time deposits
  - Savings deposits
  - Checking deposits
- Cost of funds mobilized from commercial sources (interest, fees, etc.)
  - Total
  - As a percent of amount of funds mobilized
- Administrative costs
  - Total
  - As a percent of amount of loans outstanding
- Income (interest and fees)
  - Total
  - As a percent of amount of loans outstanding
- ROA
- ROE
- Increase in number of full-time employees (beginning as compared to end of relevant period)
- Increase in number of paid employees (non-family) (beginning as compared to end of relevant period)
- Increase in sales (beginning as compared to end of relevant period)
- Increase in value of fixed assets (beginning as compared to end of relevant period)

## Annex A

# Support for the provision and institutionalization of business finance services in Kosovo

## Scope of work

- I. **SUMMARY:** The purpose of this task order is to analyze the policy and institutional constraints limiting the availability and efficiency of financial intermediation services in Kosovo, and to review and prioritize options for an effective business finance facility and associated business development intervention strategy in Kosovo. The ultimate purpose of this strategy would be to facilitate development of a support program which will promote the provision of critical capital financing to business enterprises in Kosovo (primarily to SMEs), and to support the development of a sustainable business financing capability and system in Kosovo.

This effort will focus on the constraints to the development of a sustainable business financing system in Kosovo; analyze alternative approaches for addressing these constraints; and provide concrete and detailed recommendations on the development of a strategy and framework for a USAID-supported business financing strategy and facility, and a corollary business development support effort. The analysis and recommendations will take into account past donor and USAID experience in the provision of credit financing facilities and the development of business finance institutions in developing and transitional economy countries, and current and proposed donor programs in Kosovo. They will also take into account the unique geo-political and institutional circumstances currently found in the province.

- II. **Background:** USAID/Kosovo is currently providing crucial support to the Pillar Four Administrative Unit of the U.N. Mission in Kosovo (UNMIK), which is in charge of Kosovo's economic reconstruction. It is supporting the design and implementation of a basic macroeconomic policy framework and market economy oriented policy and institutional infrastructure in Kosovo. This in turn will allow the Kosovar private sector to begin to contribute effectively to the reconstruction of the economy and the improvement in the living conditions of the Kosovar population.

In the financial sector, Kosovo is working to rebuild a viable banking sector and put a functioning payments system in place. Kosovar banks were systematically drained of financial resources by the FRY during the past decade; while the operation of the payments bureau was directly linked to the FRY and became moribund with the cessation of the military conflict. UNMIK's goal has been to put in place a rigorous and functioning banking regulation framework and system; and an operational cash-based payments infrastructure.

Significant progress in these areas has in fact been achieved. The Banking and Payments Authority (BPK) has been established and operationalized. USAID support for the BPK has focused on finalization of enabling regulations and development of rigorous bank licensing and supervision provisions. Most notably, the BPK and commercial banking regulations regulation were put into effect, establishing a rigorous bank licensing system and tight financial reporting and performance requirements which will promote financial sector stability. This includes a strong regulatory framework for micro-finance institutions. To date, one bank and several micro-finance institutions have been approved for operations in the province, while several other banks are in the application process. In addition a rudimentary payments system infrastructure has been introduced; and has facilitated payments to public sector employees and program beneficiaries. Efforts are currently underway to establish a computerized system (expected to be in place during spring 2000) which would facilitate the electronic transmission of payment information.

In the private sector development area, a basic strategy for encouraging private sector investment in and management of public enterprises, based on the application of intermediate steps towards privatization, such as concessions/leasing agreements and management contracts, has been developed. With USAID assistance, the first such concession arrangement is near completion (Sharr Cement Plant) that will serve as a precedent for future concessions of State owned enterprises. In addition, the establishment of the Kosovo Public Property Agency has been agreed upon and preliminary steps taken to define its future activities.

Concurrently, USAID legal specialists continue to proactively dialogue with UNMIK colleagues on concrete strategies and legal justification for direct and deliberate movement toward full privatization of selected state enterprises, within the framework established by UNSCR 1244 and subsequent implementation guidelines. The UN headquarters in New York continues to hold to the view that UNMIK administration of state-owned assets does not include disposal rights, and dialogue on this core issue between UNMIK legal and economic policy officials and UN-New York continues. In addition, USAID specialists are finalizing tender documents for competitive bidding for an initial management contract involving a cement factory with approximately eight hundred employees.

USAID commercial law specialists have developed a prioritized set of business legal/regulatory reforms required for private sector development. Priority areas for improvements include the company law (including business registration provisions); contract law; secured transactions; land use/ownership; and bankruptcy regulations. As noted above, privatization legal strategy issues are the subject of ongoing intensive analysis and discussion. A draft concession regulation has been developed for discussion within UNMIK. Draft regulations covering contractual rights, company formation and organization, secured transactions, bankruptcy, and concessions/leasing arrangements have been developed.

The financial sector regulatory reform and corollary privatization and commercial law reform and institution-building support initiatives described above will help ensure that banking institutions which set up and conduct operations in Kosovo function in an efficient manner and contribute to the medium to long-term financial stability and

growth of Kosovo. They are also intended to promote a healthy investment climate in which banks are able to lend to viable clients and to operate within the context of a well-defined set of enforceable commercial transactions rights. However it will undoubtedly take a significant period of time before these reforms are fully operationalized and institutionalized. This factor, and the uncertainty characterizing the geo-political and institutional environment in Kosovo, will likely inhibit strong and experienced financial institutions from moving proactively to set up operations in Kosovo in the very near term.

The donor response thus far has focused on traditional microfinance and directed credit financing facilities. Frequently these programs, when applied in the past, have failed to contribute significantly to the creation of a sustainable financing environment for small and medium-sized business in developing and transitional economy settings. Under these circumstances, it is crucial that a creative market-oriented solution to the problem of the short to medium term financing needs of private Kosovan companies be developed; which is also capable of contributing to the longer-range development of a stable and efficiently functioning banking system in Kosovo.

- III. Statement of Objectives:** The work activities envisaged in this task order will be geared towards development of a practical business financing strategy and facility, and corollary business advisory support strategy, which will effectively contribute to meeting immediate business finance and non-financial support needs in Kosovo; while contributing simultaneously to institutional development of the Kosovo's financial system. The contractor carrying out these activities will assemble a small team of seasoned experts in the commercial banking and development finance fields.

This team will then carry out a series of research and analysis activities related to the design of a business finance and support strategy and mechanism. First, it will assess financial service markets, and analyze and prioritize current policy and institutional constraints to the development of a viable financial services system in Kosovo. Second, it will perform a detailed analysis of the viability of alternative approaches to improving the availability of market-based SME financing in Kosovo. This will include, but not be limited to, the setting up of a separate legally self-contained SME financing facility; the operation of an SME credit facility through a licensed commercial or development banking institution; the setting up of a rediscount line-type financing facility for use by eligible licensed commercial banks; development of a loan guarantee facility; the utilization of donor financial and/or technical resources to attract a viable regional or international banking institution into Kosovo; the establishment of an equity fund to provide venture capital to fledgling private entrepreneurs; and the utilization of seed capital to attract reputable international or regional investors to set up and operate an equity fund-type operation in Kosovo.

Third, it will appraise non-financial service needs of the SME sector, and provide an assessment of the viability of different approaches to the provision of corollary business advisory support services targeted towards potential loan or equity capital recipients. These will include generally: business training; consulting services; and business information facilities. Fourth, it will assess potential institutional arrangements and

implementational modalities, and provide a detailed strategy for a sustainable market-based SME financing and business advisory support program in Kosovo.

- IV. **Deliverables:** The work activities envisaged in this task order will be geared towards development of a practical SME financing strategy and facility, and corollary business advisory support strategy, which will effectively contribute to meeting immediate business finance needs in Kosovo; while contributing simultaneously to institutional development of the province's financial system.

A small experienced team of banking and development finance experts will carry out the tasks enumerated above. The team will also include at least one specialist with detailed knowledge of and experience with donor business development strategy and programs.

The team will provide USAID with a detailed background analysis of the financial and SME sectors, an assessment of current and potential supply and demand for financial and non-financial services (including programs of other donors), an analysis of constraints to their further development, and recommendations for viable program options in Kosovo. It will provide a series of detailed recommendations to USAID on the most viable strategy and support modalities, with consideration given to other donor or privately financed programs. It will propose an appropriate approach and the major elements of a USAID program for a market-oriented business finance and support program, which would detail institutional arrangements, resources requirements, implementational time frames, expected results, donor coordination mechanisms. Special attention will be given to ensuring appropriate levels of independence between the financing and business advisory functions, ensuring appropriate "market screening" of business financing proposals. Also, the USAID program will consider special design features to ensure the non-discriminatory provision of SME support services, and address SME development priorities in minority areas.

- V. **Tangible Results/Benchmarks:** The contractor understands and agrees that achievement of the Tangible Results and Benchmarks are the essence of the task order and that USAID will judge the contractor's success (or lack thereof) in the task order based upon whether or not the Tangible Results and Benchmarks are achieved. In the event that any one or more of the Tangible Results or Benchmarks are not achieved or should the contractor at any point realize that they are not achievable, then the contractor shall immediately advise USAID in writing and, in the next report required as part of the task order "Reporting Requirements," shall provide a complete explanation of the circumstances relating thereto.

### Benchmarks

The contractor is expected to field a senior team of experts in commercial banking, development finance and business development areas within 7-10 days from signature of the task order.

- Within 10 days after arrival in the field, the contractor will submit to USAID/Kosovo a detailed report (15 to 20 pp.) describing financial and nonfinancial service markets and development constraints in Kosovo; and an initial comparative analysis of alternative strategies for an effective support strategy and program.

- Within 21 days after arrival in country, the contractor will submit to USAID/Kosovo a detailed report (35 to 40 pp.) containing a detailed description of the optimal business financing support and corollary business advisory support modality; provision of a concrete and sequenced series of institutional and administrative steps required for implementation of the proposed business finance support modality; and preparation of any additional analyses/memoranda that will be required by USAID for effective delineation of the strategy and support modality.
- Within 3-5 days after receipt of comments from USAID/Kosovo regarding the aforementioned report, the contractor will prepare a final version of the report which responds to all comments/suggestions made by USAID/Kosovo staff.

**VI. Personnel Requirements and Estimated Level of Effort:** The team will be composed of 2 expatriate commercial banking and development finance experts and one business development expert. One should have a minimum of 8-10 years of experience in commercial banking; and one should have a minimum of 10- 15 years experience in development finance analysis; and one should have 8-10 years experience in the provision of business advisory services in a developing/transitional economy context. The team should also include one expatriate administrative assistant with 5-8 years of program/project management experience. The team should also include up to two local banking and finance experts with at least 3-5 years experience. The duration of the task order is estimated to be approx. 4 weeks, commencing o/a May 20, 2000. The level of effort for this task order is estimated at 120 expatriate and 134 local person days as follows:

<b>Labor Category (Expatriate)</b>	<b>Estimated Days</b>
Business Finance Expert	24
Development Finance Expert	24
Business Development Specialist	24
Administrative Assistant	24
	<hr/>
	120
<b>Labor Category (Local)</b>	<b>Estimated Days</b>
Finance Specialist (2 persons)	48
Translation/Support ( 4 persons)	96
	<hr/>
	134

## **VII. Special Instructions**

1. The COTR for this task order is Paul Davis, Chief of the Office of Economic Restructuring, USAID/Kosovo.
2. The advisors working in country shall report to the COTR on a daily basis on project progress.
3. Expatriate and local advisors are authorized to work up to six days per week

4. The Contractor must obtain COTR or designee approval before making any changes in the expatriate personnel stated in the Order. Additionally, the contractor must obtain the written approval of the COTR or designee if any key person under this order will be out of the country or working on other projects at any time during the project being implemented during this task order.
5. For the duration of the task order, the Contractor shall provide the personnel to work on-site. Travel off-site must be limited to essential trips related to the task order, and must be approved in advance, in writing, by the COTR.
6. The Contractor must establish adequate administrative controls for local national employee and expatriate time charges by maintaining time and attendance records. The Contractor shall establish records, premises and facilities for any *commercial activity* (non-USAID related) separate from activity conducted under the USAID contract. To avoid any appearance of impropriety involving USAID (or U.S. Government) funded activities, a clear distinction between office activities relating to commercial work and USAID activities must be maintained.
7. The contractor shall have *adequate administrative systems* (i.e., maintaining appropriate telephone logs) to segregate personal and commercial telephone calls from USAID project telephone calls in its billings to USAID. Absence of a system to properly identify project, personal and commercial telephone calls could result in total telephone charges being disallowed.
8. Before having *interviews with the media, issuing press releases, holding news conferences*, or otherwise communicating with the media regarding activities under this task order, the Contractor will consult with the COTR or designee.

## VIII. Reporting Requirements

Pursuant to AIDAR 752.7026, the cover page of all reports prepared by the Contractor shall include a descriptive title, the author's name(s), the contract and task order number, the Contractor's name, the name of the USAID Project Office and Cognizant Technical Officer (CTO), and the publication or issuance date of the report.

1. ***Diagnostic and Program Design Reports:*** Each of the reports enumerated in section V above should be submitted in accordance with the schedule detailed in Section V.
2. ***Completion Report:*** At the time the contractor submits the final strategic design report specified in section V, it will submit a companion completion report (approximately 15-20 pp.) detailing in summary form the rationale for the business finance and support approach proposed; delineating institutional points of contact (including other donors) utilized in the course of the work; and analyzing and prioritizing ongoing implementation issues to be faced in successful implementation of the business finance and support strategy proposed.

## **Annex B**

### **Summary of information on financial institutions**



## Microenterprise lenders

Institution	Loan capital available	Market segment	Deposit taking	Interest rates	Tenor	Loan range / avg. size	Total loan portfolio (DM)	No. of clients	Area served
Malteser	N/A	Mi, S		N/A	3-7 months	DM 5,000-30,000	N/A	N/A	Mitrovica (NW) region, Prizren (SW) region
Solidarities	N/A	Mi		Below mkt. rate	Repayment in kind/cash	Avg. DM 10,000	N/A	N/A	Gjakova (SW) region
Intl. Cath. Migration Committee — Kosovo Enterprise Project (ICMC-KEP)	N/A	Mi		1.25%/mo. flat (APR about 30%)	6-8 mos.	DM 1,500-3,000	N/A	N/A	Western half of province
Grameen Trust w/It. Group	N/A	Mi		Market rates	1 yr.	DM900-2,700	Not open	Not open	Pristina (North Central)
Work Relief (Beslidhje)	N/A	Ni		1.5%/mo. flat	N/A	DM1,500	N/A	N/A	Pristina and eastern half

### Existing Kosovo credit sources

Institution	Loan capital available	Market segment	Deposit taking	Interest rates	Tenor	Loan range / avg. size	Total loan portfolio (DM)	No. of clients	Area served
Micro Enterprise Bank (MEB)	DM 4.5 million	Mi, S, M	Yes	Gold loans, 3-5%/mo.; enterprise, 1.5%/mo.	24 months	Gold loans to DM 2,000; Micro/small enterprise DM 2-40,000; 2% loan fee	SME DM 1.4 million	120	Pristina, SW, W, and central east provinces
FINCA	N/A	Mi, S, M		1.5%/mo. flat	Group: 4 mos.; SME: 2 yrs.	Group: DM 500-1,000, avg. DM 800; SME: DM 3-10,000; avg. DM 6,000	DM 140,000	130	Prizren (SW) region
World Bank/ICU with EAR	DM 10 million each	S, M		DM ref. rate + 3%	3 mos. – 2 yrs.	Max DM 500,000, avg. DM 250,000	Not open	Not open	Pristina-based with natl. business assoc. ties
Mercy Corps Intl. (MCI)	N/A	Mi, S, M		1.5%/mo. Flat	1 yr. – monthly repay.	DM 1,800-90,000, avg. DM 50,000	N/A	N/A	Pristina (North Central)

## Pending registry of commercial banks

Institution	Loan capital available	Market segment	Deposit taking	Interest rates	Tenor	Loan range / avg. size	Total loan portfolio (DM)	No. of clients	Area served
Mortgage Credit Bank	DM 5.4 million	S, M, L	Yes	N/A	Short and long term	N/A	DM 16.6 million	N/A	Entire country
BankKos	DM 5 million	S, M	Yes	16% / year	N/A	DM 2,000 – 300,000	DM 76 million	N/A	Entire country
Banka Ekonomike	DM 3.3 million	S, ind.	Yes	1.5% / mo.	Max term: 24 months	Enterp.: DM 5-50,000, ind. DM 2-10,000	DM11.7 million	Not open	Pristina, Gjakova (SW), Prizren (SW)
Banka Kreditore	DM 3.1 million	S	Yes	1.5-2.0% / mo.	Short term up to 9 months	DM 5-30,000	DM 3.7 million	N/A	Pristina, Peja (W), Gjilan (E)
EKO Bank	DM 3 million	N/A	Yes	N/A	N/A	N/A	DM 14.9 million	N/A	Pristina & south
Trading Bank of Kosovo	DM 3 million	S	Yes	1-1.5% / mo.	3-12 months	DM 6-9,000	DM 11.3 million	N/A	Pristina

## **Annex C**

### **Budget for a de novo financial institution**

This annex presents a budget for a de novo financial institution in Kosovo and contains the following parts:

#### ***Suggested list of banking services***

This part describes the basic loan products that would be appropriate for the Kosovo market for SMEs at this stage of its development. These loan products could be offered by a nonbank lending facility or by a full service bank. It might be appropriate to start out with a lending facility, because it would take less time to organize and start operating than a full service bank. The bank, which takes longer to organize, if and when opened, would absorb the lending facility and convert it into its lending department.

The list starts with micro loans, which are intended for the smallest segment of the SME sector. Micro lending officers require different training than commercial loan officers. Micro loans would be made in the range of DM 500 to 50,000. Those loans would be for terms under one year and generally weekly, instead of monthly, payments on principal and interest.

Then we suggest commercial time loans ("time" implies a tenor of one year or less) for larger SMEs. Loan amounts would range from DM 50,000 to 500,000, perhaps more, if warranted. Commercial term loans (1 to 3 or even 5 years) are intended to finance the capital investment needs of SMEs. Term loans should always be secured. Finally, it may be appropriate to consider discounting bills and acceptances, to have a legally stronger documentation for financing of receivables.

The list continues with a set of three basic deposit products (checking, savings and time deposit accounts) for the full service bank. Deposits are intended to serve three purposes: First, to provide low cost funding, to leverage the bank's loan portfolio; second to provide a much needed public service; and third, to stimulate competition in the banking system. A depository operation generates additional and very profitable funds transfer and remittance services. For detail on these operations refer to the Payments section.

A bank can and should offer safekeeping services, but it is not obligated to do so. The advantages of offering those services are customer satisfaction and loyalty. The disadvantage is the high capital investment required in vaults and safe deposit boxes.

Finally we suggest consideration of international trade services, specifically, letters of credit and collections, both clean and documentary. These services generate fee income and facilitate import and export transactions. In contrast to the very large multinational corporations, which generally sell on an open account basis to their affiliates and distributors, SMEs need letters of credit to avoid costly prepayments for imports.

#### ***Suggested roster of officers, their functions and staff***

To estimate the budget for salaries, we had to first develop a list of functions and the officers or managers that would be required to perform the required tasks. The roster lists all bank functions

and the corresponding officer titles. Some of the functions listed are essential and others are optional, such as the Trader. Very experienced bankers might be able to fulfill more than one function, such as an Operations Manager and Branch Administration Manager in one person, as long as there are not too many branches.

The roster establishes the basis for the estimated payroll for a full service bank and for a lending facility respectively, summarized in two separate tables. Each table lists the staff needed for one main office. For the full service bank it includes its organic branch or main office branch, the estimated staff for a regular full service branch and for a limited service mini-branch. To prepare the final budget, just select the number of branches and mini-branches needed at the start. The table for the lending facility has less functions and, consequently, a smaller roster, because it does not need to service deposits or handle deposit related operations. At the bottom of each table are estimates for the space needed to accommodate the desired type of organization: Bank or lending facility and the estimated total personnel and office premises cost for each of the two types.

### ***Budget for organizational expenses (start up costs) and capital investments (in fixed assets) for a full service bank and for a financing facility***

These cost estimates are for the main office of a financing facility and for the main office of a full service bank with its organic branch. These costs represent up-front cash outlays, but they are capitalized, deferred and amortized over several years.

Organization expenses are those incurred in obtaining intangible benefits that are directly related to the organization of the business. Those expenses are normally capitalized and amortized over a five-year period.

Capital investments represent the cost of tangible assets acquired to serve the business in its operations. Those costs are capitalized as fixed assets and thereafter depreciated over the term of their useful lives. The useful life of fixed is usually determined by reference to the tax code and may range from 5 years for equipment to many more years for real estate improvements. Leasehold improvements to leased properties are normally depreciated over the life of the lease.

### **Budget for the first year of operations**

This table contains all the estimated expenses that would be incurred in operating the main office of a lending facility and the main office with the organic branch of a full service bank.

It is important to make it very clear that this is an operating expense table and it does not include other components of a complete income statement (or profit and loss statement), as it does not include interest expense or income taxes. This chart only is intended to complement the complete operating projections or forecast, when the projected asset and liability, interest and fee income, and income tax expenses have been developed. Only then will the projection or forecast will be complete.

At the bottom of the page there are partial breakeven point estimates, based on an estimated net interest income margin of 12 percent per year. At this time income tax rates were not available from the Central Fiscal Authority of Kosovo.

## Budget for a de novo financial institution

### *Suggested list of bank services*

Type	Subtype	Description	Pricing	Purpose and justification
Loans	Micro loans	Time loans under one year, secured or unsecured	Fee and interest	To finance working capital for very small vendors, artisans and tradespeople
	Commercial time loans	Time loans under one year, secured or unsecured	Fee and interest	To finance working capital, receivables and inventory for SMEs
	Commercial term loans	Term loans from 12 to 60 months, should be secured	Fee and interest	To finance improvements to plant and purchase of equipment or technology which, not being part of the conversion cycle (inventory-receivables-cash), need to be amortized and financed during the period of their useful life
	Discounted bills and acceptances	Discount of bank guaranteed short term instruments used to finance domestic and international trade	Discounted interest	Bills of exchange and acceptances are a practical way to document trade obligations where contract law is not well developed enough to depend on for factoring of receivables. This form of receivable financing, is more secure than factoring and is "self liquidating."
Deposits	Checking	Two products: Personal and commercial checking accounts	Account maintenance or transaction fees	Imperative for a depository institution. Facilitates trade and payments. Provides low cost funds for lending. Creates verifiable track record of transactions

Type	Subtype	Description	Pricing	Purpose and justification
Deposits	Savings	One product: Regular savings account	Excessive withdrawal fees	Same as above and also promotes the habit of saving money. Provides safety and convenience for micro entrepreneurs
	Time	One product with different rates for different maturities	Interest rates may be “tiered” according to the amount involved	Same as above. Promotes competition in the domestic money market.
Deposit operations	Cash	Cash deposited over the counter, in night depositories and by armored car pickup	Security deposit for overnight deposit bags & fees for armored car deliveries	Imperative for a depository institution
	Cash items	Local & foreign bank checks and drafts in local (DM) or foreign currency (FC)	Collection and, if applicable, exchange fees for foreign items	Imperative for a depository institution. Promotes the development of trade, the financial system, helps to abate risk of theft and robbery. Record of transactions.
	Incoming electronic transfers	Funds credited to the bank’s account with foreign correspondents under telex or SWIFT advice, for further credit to a customer’s account or payment to a non-customer	If applicable, exchange fees for FC items. Fees for payments to non-customers	Imperative for a depository institution and promotes efficiency in handling payments
With-drawals	Cash or other	For other see Payments	Fees for armored car cash deliveries	Imperative for a depository institution.
Payments	Cashier checks	Issuance of a check drawn on the bank	Processing fee	To withdraw funds from bank or to make local payments
	Bank drafts	Issuance of a check drawn on a foreign correspondent bank	Processing fee &, if applicable, FC exchange fee	To withdraw funds from bank or to make payments abroad
	Outgoing electronic transfers	An electronic payment order	Processing fee &, if applicable, FC exchange fee	To withdraw funds from the bank and to make domestic and foreign payments

Type	Subtype	Description	Pricing	Purpose and justification
Safe-keeping	Safe deposit boxes	For customers' valuables	Fee based on size	Fees earned help to defray the cost of the vault, which is required by any depository institution
	Custody and safekeeping	For customers' securities	Fee based on value Safekeeping fees help defray cost of vault, securities may serve as collateral for loans.	Custody means that the securities are registered in the name of the bank as agent for its customer. Safekeeping means that the physical securities are held in the bank for the safety and convenience of the customer.
Inter-national	Letters of credit	To facilitate international trade	Fees for every step of the transaction and exchange fee if transaction is denominated in FC	Very important service for importers and exporters. Promotes international trade. Very profitable service with a few well trained employees.
	Collections		Processing fee and exchange fee if transaction is denominated in FC	Same as above and this service is also required by a depository institution to handle the payment and collection of incoming and outgoing cash items



## Budget for a de novo financial institution

### *Suggested roster of officers, their functions and staff*

Position (Expatriates)	Function	Reports to	Staff
(President)	CEO	Board	Admin Assistant
(Consultants)	Advisory & training services	CEO	Interpreter
Senior Lending Officer	Supervises lenders & loan production.	CEO	Admin Assistant Lending Officers
Senior Credit Officer	Credit policy & loan administration.	Board	Admin Assistant Credit Analysts
Chief Financial Officer - CFO)	Treasury. Financial Reports. Accounting.	CEO	Accounting staff
Operations Manager - OM	Item processing. Personnel & facilities	CEO	Bookkeeping staff
Branch Admin Manager	Branch supervision & deposit production.	CEO	Branch Manager, Head Teller & Tellers and Cust Serv Reps
EDP/MIS Manager	EDP/MIS systems	OM	Systems specialists
Telecom Manager	Telecom systems	OM	Telecom specialists
Internal Auditor	Internal audits	Board	Junior Auditors
Compliance Officer	Compliance & risk assessment	Board	Assistant
Loan Proc Manager	Loan processing	OM	Loan clerks & Note Tellers
Intl Ops Manager	Letters of credit & collections	OM	Documentary clerks
Security Officer	Bank security	OM	Drivers, messengers & guards
Trader	Interbank deposits, securities & FX trades	CFO	Trading clerks

## Budget for a de novo full service bank

(in \$1,000)

PERSONNEL	Annual Salary	Main Office Staff	Branch Staff	Mini Branch Staff	Main Office Cost	Branch Cost	Mini Branch Cost
PRESIDENT	250	1			250	0	0
Admin Assistant	20	1			20	0	0
CONSULTANT	120	1			120	0	0
SENIOR CREDIT OFFICER	250	1			250	0	0
Credit Analysts	20	3	1		60	20	0
Senior Lending Officer	80	1			80	0	0
Admin Assistant	20	1			20	0	0
Lending Officers	25	2	2	1	50	50	25
Micro Lending Officers	20	2	2	1	40	40	20
Chief Financial Officer	70	1			70	0	0
Accounting Clerks	20	2			40	0	0
Operations Manager	70	1			70	0	0
Clerks	25	2			50	0	0
Branch Admin Manager	50	1			50	0	0
Branch Manager	30	1	1	1	30	30	30
Tellers	15	4	3	2	60	45	30
Cust Serv Reps	20	4	2	1	80	40	20
EDP/MIS Manager	50	1			50	0	0
EDP/MIS Specialist	25	1			25	0	0
Telecom Manager	35	1			35	0	0
Telecom Specialist	25	1			25	0	0
Internal Auditor	50	1			50	0	0
Junior Auditors	25	1	1		25	25	0
Loan Proc Manager	30	1			30	0	0
Loan Clerks or Note Teller	20	2	1	1	40	20	20
Intl Ops Manager	40	1			40	0	0
Documentary Clerks	20	2			40	0	0
Security Officer	35	1			35	0	0
Driver	10	1			10	0	0
Guard	10	1	1	1	10	10	10
Receptionist	10	1	1		10	10	0

TOTAL STAFF	45	15	8
TOTAL COST OF STAFF	\$1,765	\$290	\$155
SPACE REQUIRED IN SF	8,100	1,650	800
SPACE REQUIRED IN M2	736	150	75
COST OF SPACE \$10/M2	\$88	\$18	\$9

Space needs computed at 200 SF per employee for the main office & branch in Pristina

Space cost computed at \$10 per month per square meter in Pristina

## Budget for a de novo full service bank

(in \$1,000)

PERSONNEL	Annual Salary	Main Office Staff	Branch Staff	Mini Branch Staff	Main Office Cost	Branch Cost	Mini Branch Cost
PRESIDENT	250	1			250	0	0
Admin Assistant	20	1			20	0	0
CONSULTANT	120	1			120	0	0
SENIOR CREDIT OFFICER	250	1			250	0	0
Credit Analysts	20	3	1		60	20	0
Senior Lending Officer	75	1			75	0	0
Admin Assistant	20	1			20	0	0
Lending Officers	25	2	2	1	50	50	25
Micro Lending Officers	20	2	2	1	40	40	20
Chief Financial Officer	50	1			50	0	0
Accounting Clerks	20	2			40	0	0
Operations Manager		1			0	0	0
Clerks		1			0	0	0
Branch Admin Manager					0	0	0
Branch Manager	30	1	1	1	30	30	30
Tellers							
Cust Serv Reps							
EDP/MIS Manager							
EDP/MIS Specialist	25	1			25	0	0
Telecom Manager							
Telecom Specialists		1			0	0	0
Internal Auditor	40	1			40	0	0
Junior Auditors							
Loan Proc Manager	30	1			30	0	0
Loan Clerks or Note Teller	20	2	1	1	40	20	20
Intl Ops Manager					0	0	0
Documentary Clerks					0	0	0
Security Officer					0	0	0
Driver	15	1	1	1	15	15	15
Guard	15	1			15	0	0
Receptionist	15	1	1		15	15	0

TOTAL STAFF	28	9	5
TOTAL COST OF STAFF	\$1,185	\$190	\$110
SPACE REQUIRED IN SF	4,200	990	500
SPACE REQUIRED IN M2	382	90	75
COST OF SPACE \$10/M2	\$46	\$11	\$9

Space needs computed at 150 SF per employee for the main office & branch in Pristina

Space cost computed at \$10 per month per square meter in Pristina

## Budget for a de novo financial institution

### *First year of operations*

(in \$1,000)

OPERATING EXPENSE BUDGET	FULL SERVICE BANK	FINANCING FACILITY
Personnel, salaries, benefits & payroll taxes	1,765	1,185
Premises, leased office space (Pristina)	88	46
Office maintenance & repairs	25	15
Depreciation furniture, equipment & LHI (5 yrs)	440	140
Equipment maintenance & repairs	75	25
Misc equipment leased	75	25
Advertising & publicity	100	25
Legal expenses	100	25
Accountants (external auditors)	75	50
Amortization deferred organization expenses	137	69
Insurance: Directors & Officers, Financial Institutions Bond, Hazard & Liability, etc.	75	25
Memberships & subscriptions	25	25
Telecommunications	150	75
Postage & couriers	75	25
Armored car service	50	
Janitorial service	25	20
Printing & supplies	100	50
Travel & entertainment	100	75
Errors & omissions	25	5
Provision for loan losses	Depends on portfolio projections	Depends on portfolio projections
Miscellaneous losses	25	10
Other miscellaneous expenses	125	25
<b>TOTAL OPERATING EXPENSES</b>	<b>3,655</b>	<b>1,940</b>

## BREAKEVEN POINT ESTIMATE

12.00%

12.00%

To cover these expenses the institution will have to  
lend, using a spread of 12% over cost of funds  
However, fee income could substantially add to  
income and perhaps even cover the provisions for  
loan losses

30,458

16,167

## Budget for a de novo financial institution

### *First year of operations*

(in \$1,000)

ORGANIZATION EXPENSES	FULL SERVICE BANK	FINANCING FACILITY
Accountants' Report	75	50
Legal	100	50
Government Permits	50	25
Consulting Fees:		
EDP/MIS	75	25
Recruiting	75	50
Training	100	50
Accounting System	50	25
Policies & Procedures	25	10
Charter & Bylaws	10	5
Telecommunications	25	5
Travel, Meals & Incidentals	75	25
Miscellaneous	25	25
TOTAL	685	345

Organization Expenses are normally capitalized and amortized over five (5) years according to GAAP and International Accounting Standards.



CAPITAL INVESTMENTS	FULL SERVICE BANK	FINANCING FACILITY
Bank or Finance Accounting System		
Hardware & Software	300	75
PC Network System including PCs and Servers	200	100
Telecommunications System	150	75
Security System	75	25
Furniture & Other Equipment	500	225
Leasehold Improvements (LHI)	250	100
Signs	75	25
Tellers Terminals & Undercounter HW	175	
Check Sorting System	150	
Vaults, SD Boxes, Safes	175	25
Miscellaneous (small equipment)	150	50
TOTAL	2200	700

Capital investments are capitalized as fixed assets and are depreciated over their useful life, normally 5 to 10 years. LHI over life of the lease. These are estimates for a main office, including main branch in Pristina. Until we know how many branches are desired we cannot estimate total. These estimates are subject to variation based on freight, duties and installation costs in Kosovo. They may also vary as time passes and new more desirable technology becomes available. Other decisions not yet taken, types of products and services offered, specific locations, condition of properties and available facilities may also have an impact on these estimates.